# STABILIZATION OF THE FOREIGN EXCHANGES

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To

MY MOTHER

CHRISTINE M. JAEGER

# FOREWORD

THE world-wide interest recently manifested in the subject of foreign exchange has been the inducement to the present study. The purpose of the following pages is to analyse the course of the individual rates in order to bring out the causes which determine the fluctuations in the exchange market. That there is no single, universal formula for solving the exchange problem but that stabilization depends entirely on the correction of the conditions which produce disturbances in the exchange market is the underlying thought of the present study.

The scope of the work has been limited to a discussion of the exchanges of the four major European belligerents. The non-European and neutral exchanges present problems which differ in character from those of the European countries which have recently been at war; whereas the scanty and uncertain information on Russia and the tangled situation in the Succession States do not allow a thorough consideration of their exchanges.

To Professors Edwin R. A. Seligman and H. Parker Willis the writer is under special obligation for the criticism which they have brought to bear upon the present study.

The author desires also to acknowledge the cooperation of Professors Harold G. Moulton and E. E. Agger who have made valuable suggestions. Despite this generous aid, however, she is aware that many omissions and imperfections remain.

RUTH M. JAEGER.

Columbia University, *May 1922.*

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# CHAPTER I.

## INTRODUCTION.

SINCE the Armistice the problem of the foreign exchanges has assumed a place of paramount importance. The fluctuations of the past few years have been so wide and so sudden and their effects so far-reaching that they have become a question of enormous moment not only to the business community but even to the general public.

Yet, though the recent movements seem unexampled in rapidity and extent, and though the scope of their influence appears to be without precedent, instances are not lacking in the history of monetary developments when currency and exchange were prey to the same disorders and the same demoralization. The dislocation of commerce and industry resulting from the events of the early part of the Thirty Years' War was not without its effect on the exchange situation.

> Von allen Schrecken des beginnenden Krieges erschien dem Volk selbst keiner so unheimlich wie eine plötzliche Entwertung des Geldes. . . . Schon seit längerer Zeit war an dem Gelde, was im Lande umging, ungewöhnliches bemerkt worden. Des guten, schweren Reichsgeldes wurde immer weniger. . . . Noch befremdlicher fiel auf, dass die fremden Waren fortwährend im Preise stiegen. Man empfand eine konstante Teuerung. Wer ein Patengeschenk machen wollte, oder fremde Kaufleute bezahlen musste, der zahlte für die alten feinen Joachimstaler ein immer wachsendes Agio.[1]

Similar words would illustrate the evil results of the continental currency, of the Mississippi Bubble and of the *assignats*.[2] The famous Bullion Report of 1810 clearly emphasized the untoward effects of the Napoleonic Wars.[3]

The upheavals of the recent European War caused fluctuations in the exchange market which have world-wide significance. The course of the market for foreign bills forms a problem of well-nigh insoluble complexity to experts and bankers, and of great importance to the trader, the merchant and the manufacturer, and also to legislative bodies, public treasuries, and the general public.

Most far-reaching are those influences resulting from the movements of the exchanges which affect the entire commercial develop-

[1] Gustav Freytag, Bilder aus der Deutschen Vergangenheit, Frankfurter Zeitung, October 21, 1921.

[2] E. R. A. Seligman. Currency, Inflation and Public Debts (New York, 1921), passim.

[3] Select Committee on the High Price of Bullion (London, 1810), p. 34.

ment of a country. "The fluctuations of foreign exchange cause perturbations and embarrassments from which the whole economic life of the country severely suffers."[4] The most vivid illustration of a country whose entire trade and commerce has been profoundly troubled by the vagaries of exchanges entirely foreign to its own is furnished by Holland.

The general depression in international trade during the year now closing, together with the movements in foreign exchange, and especially the slump in the German mark, has had a profound influence upon the economic development of this country. A large part of our troubles can be traced to the fluctuations in the exchange market. They hamper international trade considerably and the progressive depreciation of the German Exchange constitutes a permanent and serious menace to our trade and industry.[5]

The country suffering most severely from exchange fluctuations is Germany. Since the mark is now undervalued, now overvalued on the world market, business in Germany is now at the heights of prosperity, now in the depths of depression. "Calamity booms" follow "improvement depressions" in rapid rotation. When the value of the mark falls Germany works overtime to fill export orders; when internal prices have caught up to world values workers are idle and industry is depressed.[6] Even the United States, less subject to the harrowing experiences of a variable money, has not been entirely spared the evil effects of exchange fluctuations.

Despite such evidences of improved industrial conditions in Europe, nevertheless European exchange rates continue to fluctuate weirdly. The causes for the depreciation of those exchange rates are not being remedied, and no practical measures for securing stability are in sight. Therein lies the large element of uncertainty that may directly and indirectly affect the course of business prosperity in the United States during the next twelve months.[7]

Less widespread but perhaps more insidious is that element in exchange fluctuations which injects into all trade relationships an element of uncertainty so incalculable, so formidable, that it undermines the very foundations of commerce. "Business loses its genuine character and becomes no better than a speculation in the exchanges."[8] True, it is possible, when countries have goods to export, to carry on

[4] E. R. A. Seligman, *op. cit.*, p. 59.

[5] New York Evening Post, Amsterdam Correspondence, December 24, 1921.

[6] Cablegram to H. Hoover from Commercial Attaché, C. E. Herring in Berlin, Daily News Record, November 16, 1921.

[7] M. T. Copeland, "Recovery Waits on Europe," New York Evening Post, November 5, 1921.

[8] J. M. Keynes, Economic Consequences of the Peace (London, 1920), p. 243.

trade under conditions of unstable currency. The interchange of commodities in such cases is, however, very limited. What is more important, prices of goods are quoted in terms of foreign money. Thus not only is trade established on a basis of a stable monetary unit, but the transactions do not even require the conversion of a foreign into a domestic currency.[9] Where, however, the interchange of commodities mounts to large proportions and where traders, because of their unavoidable domestic connections, adhere to their own currencies, the fluctuations in exchange become a subject of constant worry.

Fluctuations in foreign exchange such as are now in daily occurrence introduce a serious element of risk into foreign commercial transactions. If an American exporter had accepted an order three months ago to be paid for October 20 in marks, he would have received less than three-fourths as much, in gold value, as at the time of contract. In July of this year 1,000,000 marks were worth approximately $10,000; on October 20, $7,000; on October 21, $6,000; and a few days earlier less than $5,500. If a German buyer had contracted in July for $50,000 worth of merchandise to be paid for in October in dollars, the goods would have cost him not 5,000,000 marks, as in July, but between 7,000,000 and 10,000,000 marks, depending upon the day in October that payment actually was made. Obviously, trade cannot prosper in the face of such fluctuations.[10]

In a position almost as difficult are American importers when the European exchanges rise.

The head of what is probably the largest firm of linen importers in the United States said that every four cent rise in sterling exchange meant to his company a 1 per cent reduction in profit.

A big importer of English woolen piece goods who sells to the merchant tailoring trade here said that he had suffered a loss already of 25 cents a yard on 20 cases of merchandise. "As it is," he added, "we have right along been selling goods at 50c a yard cheaper than we should."

At James McCutcheon & Company, it was stated by William E. Speers, treasurer, that "we will have to swallow the loss." Catalogs listing new prices had been published, it was pointed out, and there was nothing for the firm to do "but take the bitter with the sweet."[11]

[9] Alvin W. Krech, president of the Equitable Trust Company, points out that although stable currency is desirable, it does not seem to be essential to free commercial interchanges of commodities and credits between nations. The banker refers to the ability of Mexico and Colombia to do business with the United States, although the currencies of the first two countries had fallen to a nominal value. Trade can be continued, he stated, so long as countries with depreciated currencies have something to export.

"Under such circumstances," said Mr. Krech, "the currency used must of necessity be foreign currency and foreign countries can deal with nationals of countries whose currency is valueless as long as the integrity of the persons are in control of exports sufficient to enable them to obtain foreign currency having an established value."—New York Times, December 19, 1921.

[10] M. T. Copeland, New York Evening Post, November 5, 1921.

[11] Daily News Record, December 14, 1921.

Not only to merchants but to manufacturers as well the fluctuations in the foreign exchanges are an unending source of anxiety. Where a producer is dependent for his raw materials on importation from foreign countries he must be sure that when he has turned out his finished products he can obtain for them values which, when converted into the currency of the country whence he drew his raw materials, will pay in full for his import. Where, however, both the home currency and the foreign rate fluctuate, and sometimes in opposite directions, the manufacturer is in a dangerous position.

It is a hazardous enterprise for a merchant or a manufacturer to purchase with a foreign credit, material which, when he has imported or manufactured it, he will receive mark currency of a quite uncertain and possibly unrealizable value. He will owe sterling or dollars but he will sell his product for marks, and his power when the time comes to turn these marks into the currency in which he has to repay his debt is entirely problematical.[12]

Again, the European Banks, which are often closely allied to large industrial enterprises, inevitably suffer from the consequences of unstable exchange rates.

The real wonder is not that one great bank has got into trouble, but that in the utterly disorganized condition of the finances of the world, and the violent fluctuations of exchange, cases of embarrassment on a large scale have not been more common. It is a very usual practice with Continental banking houses to adopt the course which has brought misfortune upon the Banca di Sconto. They are in the habit of allying themselves closely with the industrial concerns, such as the Ansaldo Company. This compels them to lock up a large part of their capital in the particular businesses, with which they connect themselves.[13]

Exchange fluctuations play havoc not only with the finances of the business world but also with the fiscal problems of governments. In those countries which have found it necessary to maintain bread subsidies, the rate of New York exchange determines, in large measure, the amount of the government deficit.

Basterebbe un efficace temperamento dei cambi per permetterci, con la diminuzione di tutti i costi, risparmi sensibilissimi. . . . L'oratore osserva che se il miglioramento dell'economia generale, ed in ispecie la diminuzione dei cambi, dovessero verificarsi, la prima cifra che ne risentirebbe vantaggio sarebbe quella di oltre 6 miliardi—trasporti compresi—che oggi costituisce l'onere sopportato dall' Erario per il prezzo politico del pane: ed egli sarebbe ben lieto che per questa via gradualmente il grave problema potesse risolversi. . . .[14]

[12] J. M. Keynes, *op. cit.*, p. 242.

[13] London Times, December 30, 1921, review of the failure of the Banca Italiana di Sconto.

[14] Meda, Minister of the Treasury, Corriere della Sera, June 29, 1920.

Should the United States decide, in accordance with the provisions of the Debt Funding Bill, to exact payment of interest and sinking fund on the advances of the United States government to the European countries, treasury officials would find their budget estimates upset at every change in the quotation of dollar bills.[15] In Germany, the fall of mark exchange has caused the government to default on Reparation payments. Although the Reichsbank was able to raise sufficient paper marks to cover the instalment due during the first two weeks of December, the sudden depreciation of Berlin exchange made conversion impossible.

Germany has failed to pay 190,000,000 gold marks due during the first two weeks of December under the schedule of payments calling for 26 per cent of her exports and certain portions of her custom duties, it was learned to-day.

The German Government has informed the Reparations Commission that the tremendous decrease in the value of the mark makes impossible the conversion into gold marks of the fund of paper marks which has been accumulated to meet these payments.

The schedule provides that Germany shall deposit a sufficient number of paper marks with the Guarantee Committee of the Reparations Commission to meet these payments. A total of 3,000,000,000 paper marks has been deposited with the Committee. This sum would have represented a substantial amount of gold marks except for the violent downward movement in the price of the mark. It is understood that the German government holds that, in view of the present value of the mark, it should not be required to convert paper marks into gold to meet the payment. The paper marks deposited will be held by the Reparations Committee in the hope of some restoration of their value.[16]

That part of the mechanism of international exchange which, before the war was deemed worthy of attention only by experts, has now become the concern of business men, of government officials, and of the public in all countries. In view of the widespread, well-nigh universal effects of exchange fluctuations on trade and production, on banking and finance, on budgets and state expenditures, it is by no means surprising that the world has come to look upon stabilization of the exchanges as a milestone on the road back to "normalcy."

Loosely used by those who see in exchange fluctuations a menace to trade and industry, the term *stabilization* conveys distinct meanings to different people. To some it connotes a restoration of the prewar parities; to others it implies an official recognition of depreciation, the establishing of a new parity on the basis of this devaluation and the elimination of fluctuations when the new rates have been fixed. "The idea of stabilizing exchange is often urged in the sense of eliminating the fluctuations of exchange, but latterly many have em-

[15] *Cf.* Henri Cheron's estimate, Journal of Commerce, Febuary 17, 1922.

[16] Associated Press (Paris), December 10, 1921.

ployed it as meaning the restoration of the original par or a figure approximating par in given exchanges."[17] Some would establish the currencies on a new basis immediately and definitely; others would attempt a gradual restoration either to the old rate or to a new par. ". . . die Herstellung eines endgültigen Valutenkurses, der nun dauernd unter allen Umständen so behauptet werden soll wie vor dem Kriege die Relationsparität; andere dass man die Besserung der Krone stufenweise durchführen soll."[18]

In its most accepted usage the term stabilization simply means the elimination of fluctuations in exchange. Whether this stability is to take place on the basis of the pre-war level or of a rate fixed in relation to the existing devaluation must depend on how far the particular country has strayed on the paths of depreciation.

In normal times before the European War the term *stabilization* was rarely heard in connection with the foreign exchanges. Foreign exchange was a mechanism so delicately adjusted and in such excellent working order that it fulfilled its purpose unnoticed. The countries adhering to the gold standard liquidated ultimate balances by the shipment of bullion from the debtor to the creditor country; consequently exchange could not move beyond the specie-points. Where the maladjustment in the equilibrium of international accounts was due to temporary or seasonal causes, countries could avoid the transmission of bullion by a change in the rate of interest. A raising or lowering of the discount rate usually tided nations over a period of temporary maladjustment in the balance of international obligations.[19]

The elements which give rise to the supply of and demand for bills of exchange are the sum total of debts and claims. Those international settlements which result in a supply of bills on a country and which cause gold to leave the country are reckoned as imports. These are imports of merchandise, the making of a loan, payment of interest, profits or commissions, withdrawals of money by citizens of a country for travel abroad and immigrants' remittances to their home country. Conversely all transactions which give rise to an inflow of specie, or which create a demand for bills of exchange are counted as exports. These are exports of goods, receiving repayment of a loan, receipts of interest and profits, tourist expenditures and emigrant remittances.

Exchanges do not, however, depend on the balance of debits and credits with each country separately but with all countries taken as a whole; in the main the exchanges with all foreign countries vary to-

[17] H. Parker Willis, Stabilizing the Foreign Exchanges, Bankers Statistical Corporation (New York, 1920), p. 1.

[18] Neues Wiener Tageblatt, Juli 31, 1921.

[19] Goschen, Foreign Exchanges (London, 1843), *passim*.

United States National Monetary Commission Report, Bank of England, p. 20.

gether as the country has a balance to receive or to pay as a general result of its foreign transactions.[20]

Whereas the exchange of a country on the gold standard can fluctuate only to the extent of the cost of shipping specie, there is, theoretically, no limit whatever to the movements below par where a country has an inconvertible paper currency. Should the balance of trade of such a country ever be in a state of equilibrium the price of bills would be the old par minus the depreciation of the currency with respect to gold. Such a case is, however, almost purely hypothetical since a country relying on an inconvertible paper standard usually has an excess of imports. The discount on the currency of such a country in foreign centres may thus be practically unlimited.[21]

Before the war, international trade, long-developed, had brought about such a distribution of the precious metals and such a level of prices in the several countries that their exchanges, sensitive to a slight premium on exchange, a small differential on the return for capital, or driblet movements of gold, fluctuated within very narrow limits.

In antithesis to this smooth and well-defined working of exchange during ordinary times is the hectic war and post-war experience. Barring the first feverish movements due to the outbreak of the war, when panic-stricken buyers and sellers wanted to settle claims and debts at once for fear of defaulting on them by waiting,[22] the fundamental, the basic reason for the violent movements of the exchange market is the upsetting of the pre-war balance of indebtedness. Before 1914, a slight premium on exchange, a raising of the rate of interest, or, at most, a moderate flow of specie encouraged exports,[23] re-established that delicate equilibrium of claims and debts whereby the pre-war world lived; after July, 1914, the embargo on gold made impossible an export of specie and thus abolished the specie-points; unprecedented imports piled up claims against the belligerents, increased the supply of bills on them, and tended to put their exchanges at a discount in New York; though, under normal times, this would have acted as an incentive to export, this corrective was also inoperative, due to the restrictions on exports of goods and capital; while a raising of the rate of interest was both impossible and useless: impossible because the government wanted to borrow at low rates, and useless since, with moratoria established in most of the countries, capital could not flow freely, and because, in any case, the increased return would not com-

[20] J. S. Mill, Principles of Political Economy (London, 1852), Book III, Chapter 20.

[21] Goschen, *op. cit.*, p. 69.

[22] Interesting to compare a similar time when Napoleon landed on Elbe. Mill, *op. cit.*, Bk. iii, ch. 20.

[23] By exports is meant any movement acting as an export.

pensate for the risk of transference to a warring country, and the u certainties of the rate of exchange of a currency not firmly ancho to specie.[24]

[24] It is true Great Britain did borrow to "peg" her exchange, but this c not be called a corrective in the pre-war sense, since it was an artificial g ernment arrangement. Great Britain did allow an extra 2% on foreign l ances, but this was in conjunction with government operations of stabilizat *Vide infra*, p. 21.

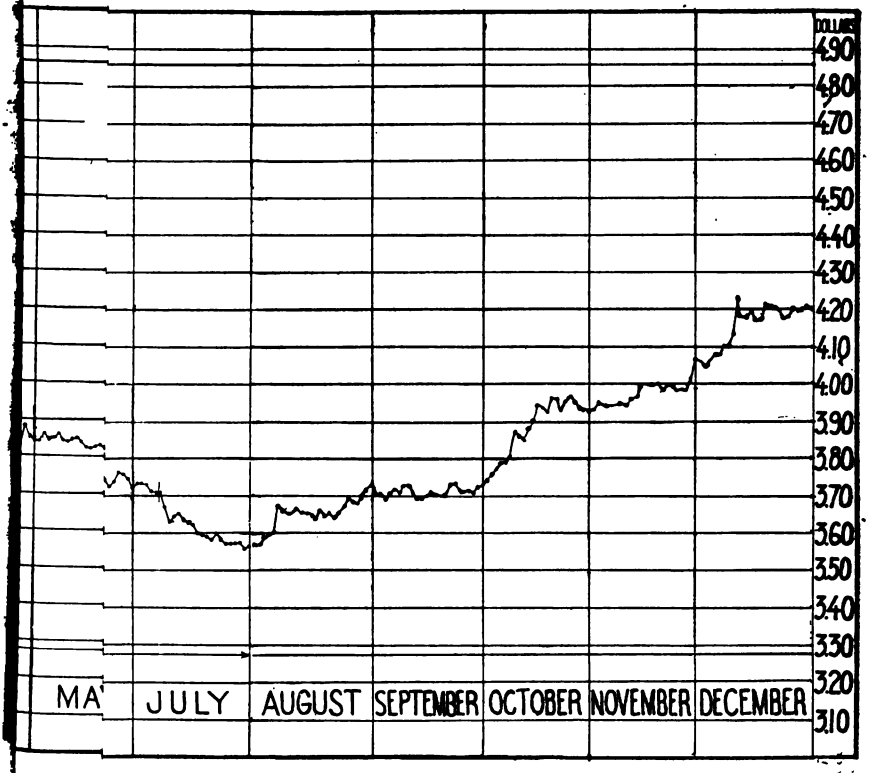
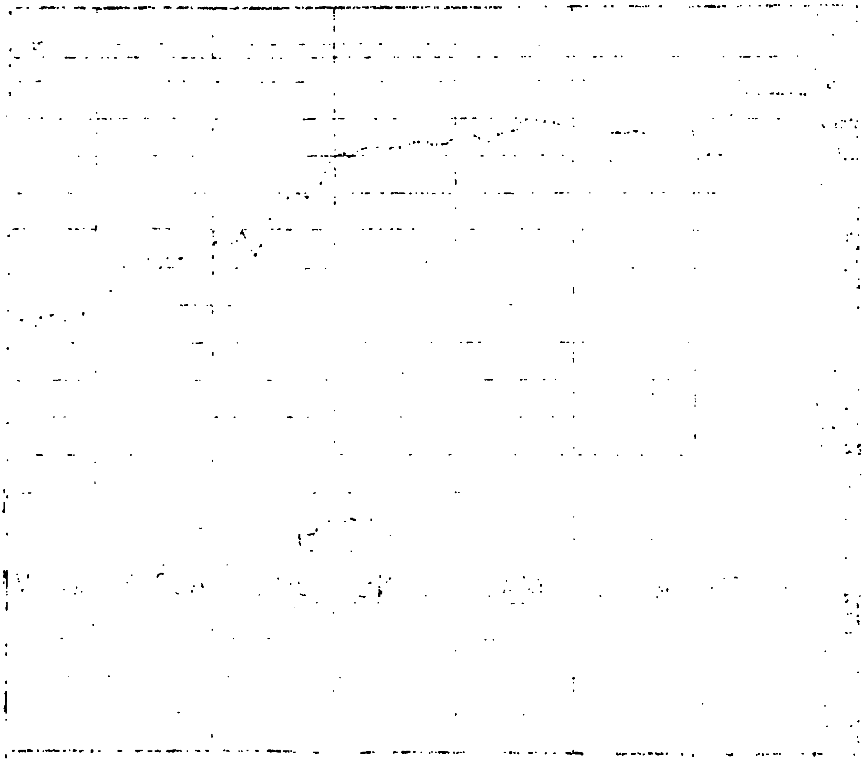



Chart for. March, 1919–July, 1921.
By H. N. Lawrie,
Economist, American Mining Congress, October 1, 1921.



## CHAPTER II.

### HISTORICAL ANALYSIS.

THE history of the foreign exchanges during the last seven years is the story of a revolution. An analysis of the rates on London Paris, Milan and Berlin shows that there were three distinct periods in the course of exchange fluctuations between July 31, 1914, and January 1, 1922: the dislocation of the foreign rates at the outbreak of the war, the period of "pegging" and the three post-war years when exchanges assumed an uncontrolled relation to one another.

The disruption of the exchange machinery at the opening of the European War practically amounted to a complete suspension of all quotations for a period of approximately six weeks. Because of the imperative need of reestablishing the mechanism of international exchange the various countries resorted to artificial measures of stabilization during the war. After the Armistice was signed and the exchanges were unpegged, quotations responded to the commercial and financial forces which the war-time regulations had held in abeyance.

### THE POUND STERLING.

Although international indebtedness in the pre-war period was in such a state of balance that the exchanges did not move beyond the narrow specie-points, the demand for immediate settlement, at the outbreak of the war, proved to what extent the flow of capital, rather than the movement of goods alone, equalized debts and claims. A cross-section of international accounts, as of July, 1914, shows that from the financial point of view, the world was divided into creditor[1] and debtor nations, and that any attempt at liquidation of unfunded balances on short notice would mean a precipitate calling in of funds on the part of creditors and a scramble to remit on the part of debtors.

Peculiarly important in this respect is the position of Great Britain. She was not only the financial center of the world, through whose

[1] In general the older European countries were creditors.
England's investments totalled £4,200,000,000 (Paish).
France's investments totalled fr. 40,000,000,000 (Klotz).
Germany's investments totalled mk. 35,000,000,000 (Reichs-Marine-Amt).

The United States was both a debtor and a creditor: a debtor to Europe, a creditor to South American countries.

The classification was substantially this:

| Creditors | Debtors |
|---|---|
| Great Britain | Russia |
| France | Balkans |
| Germany | South America |
| | Asia |

capital 50% of the world's exchange transactions passed, but she was also the outstanding creditor nation. At the outbreak of the war, the United States owed Great Britain £13,500,000 for loans on warrants due in September and $450,000,000 on a running trade balance due the following January; and on every other country—except France, which had, temporarily, a favorable balance with England—Lombard Street had a net balance of unfunded claims.[2] This clear-cut division of countries into debtors and creditors resulted, at the outbreak of the war, in a general disorganization of the exchange market.

A detailed study of exchange rates[3] at the end of July, when the European War appeared inevitable, shows that: the ultimatum of Austria to Serbia on July 23 produced no immediate effect on the exchanges, due to the general belief that the conflict would be localized; some exchanges moved uneasily during the next few days when Paris and London called in funds; considerable fluctuations followed the outbreak of the war between Austria and Serbia on July 28; and on the declaration of war by Germany on Russia on August 1, by Germany on France on August 2, and by Great Britain on Germany on August 4, there was a general collapse of the European and American exchanges. At first nominal, rates were later unobtainable; the Paris rate at one time fell to 24 francs to the pound sterling; the New York rate rose to $7 to the pound sterling.

This sudden upsetting of the exchange machinery was due to: (1) a general call in by London banks and financial houses of balances held abroad; (2) a demand by traders everywhere for sterling exchange to meet maturing liabilities in London, especially obligations to London accepting houses; since there was not sufficient sterling immediately available to meet the sudden demand and since the creation of finance bills[4] had ceased, sterling commanded a premium everywhere to the extent that those owing debts in pounds were eager to remit; (3) the collapse of enemy exchanges which reacted immediately on the exchanges of other countries, owing to the interdependence of the various exchanges; (4) the closing of the stock exchanges and the consequent difficulty of selling securities to meet maturing debts; (5) restrictions placed on the export of gold,

[2] J. L. Laughlin: Credit of the Nations (New York, 1918), p. 123.

[3] It seems best to use London to show the influence of the outbreak of the war since it was the financial center and the free market for gold.
Raffalovich, Le Marché Financier (Paris, 1920), p. 12.
Kirkaldy, British Finance (London, 1921), p. 329.
Economist (London), August 1, 8, September 19, 1914.

[4] Before the war, when the gold point was exceeded—4.885 for sterling (par 4.866)—the banks were ready and anxious to take up all bills offered. If debtors to Great Britain wanted sterling wherewith to settle claims, the American banks obtained, by means of a finance bill, a loan from a London financial house with which it had an account. The finance bill was simply *the borrowing* bank's sale of its own long draft.

thus removing the gold points and rendering the exchanges susceptible to fluctuations limited only by the need of debtors to remit, and the eagerness of fear-stricken creditors to call in their funds.[5]

Because of the absolute necessity of the restoration of the exchanges in order to resume international commerce, the British government passed measures and issued proclamations designed to patch up the machinery of exchange.[6] Since foreign clients were unable to remit, the bill brokers were in a hazardous position. In no less precarious a situation were the accepting houses. They, in effect, guarantee that a foreign bill (arising out of trade transactions either between Great Britain and a foreign country or between two foreign countries) will be met at maturity. It is largely this form of finance that made London the financial center of the world. The acceptances current at the outbreak of the war amounted to between three and three and a half hundred million pounds in the hands of accepting houses, to about seventy million pounds in the Joint Stock Banks. Foreign remittances to meet these acceptances were not forthcoming or were delayed, since all available bills on London were quickly purchased by foreign debtors for transmission to London, since finance bills were not being created and since the procuring of gold for shipment to the United Kingdom was, in most cases, impossible.[7]

On August 2, a proclamation was issued which postponed payment of pre-August 4th bills of exchange (other than checks or demand bills) for a period of one month from the date of its original maturity; on August 3rd, the Postpayment of Payments Act was passed, which extended the moratorium to other payments beside bills of exchange. These measures, though allaying the fears of the timid, left the market glutted with moratorium bills that clogged up the exchange machinery: financial institutions no longer needed to fear failure but, on the other hand, they were tied up with indefinitely long-term credit. To clear the market, it was announced on August 13, that the Bank of England, under government guarantee against loss, would discount at Bank Rate without recourse to the holders, all approved bills accepted before August 4th, and that the acceptors of such bills, discounted at the Bank of England, might postpone payment at maturity by paying interest at 2% above Bank Rate. On September 5th, the government announced that the Bank of England would provide acceptors with funds to pay all approved pre-moratorium bills at maturity. The Bank was entitled to interest on these advances at 2% above Bank Rate and undertook not to claim repayment of any sums not recovered by acceptors from their clients until one year after the end of the war. The Joint Stock

[5] *Cf. supra*, p. 15.
[6] Kirkaldy, *op. cit.*, p. 330.
Economist, September 10, 1914.
[7] Economist, September 10, 1914.

Banks undertook, with the assistance of the Bank of England, to finance new bills on similar terms; the government guaranteed the Bank of England against any loss it might eventually incur. The total advances on foreign bills under the government guarantee was £120,000,000;[8] the sum advanced on pre-moratorium bills, to enable acceptors to meet their obligations at maturity was £60,386,000, and it was estimated that at the end of the war, bills totalling £50,000,000 would remain "in cold storage." With the help of these measures, which cleared the market of dead credits and which assured financial institutions of their safety in so far as pre-war claims were concerned, London was ready to finance new trade transactions. Confident that time would be allowed to settle indebtedness, rates began to be quoted about September 15th and, by the end of the year, were within reasonable proximity of their respective parities.

No amount of proclamations alone, however, could have legislated the exchanges back to parity; it was the assurance that claims would not be pressed for immediate settlement, coupled with the counter movement of goods from the United States to Europe, which reduced the indebtedness of the United States and created a demand for bills. The war broke out in July when, due to seasonal trade, the United States owes Europe; the exchanges "were restored" after August, when the Autumn shippings of cereals and cotton normally would pay off the debt contracted with Europe during the January to June period. In addition to this normal flow of goods was the extraordinary and constantly growing volumn of imports to the belligerents. From a favorable balance of $360,000,000 with the United Kingdom, France and Italy[9] in 1913, the excess of exports to these three allies increased to $415,000,000 in 1914, and in 1915 to $1,530,000,000.[10] To pay for these imports, the pre-war means of settlement were available only to a very limited extent. With every branch of production, with every phase of industry organized on a war basis, an increase of merchandise exports was out of the question. Though no prohibition was placed on the export of gold, no bank or banker could be found who would avail himself of the benefits accruing from such transactions "because it is the general opinion that it is against the interests of this country for gold to leave England so long as other governments do not allow gold ex-

[8] Thus, of £350,000,000, all except £120,000,000 were disposed of in the regular way.
Speech: Chancellor of the Exchequer, November 27, 1914.
Kirkaldy: *op. cit.*, p. 8.
Economist, Vol. 79, p. 444.

[9] It seems best to include France and Italy because their imports were financed largely through London and thus gave rise to a supply of pound bills.

[10] *Statistical* Abstract, 1919.

ports from their countries."[11] Payment by the sale of foreign-held American securities was feasible only to the extent that the British government could make them available for use.[12] The only alternatives, if the Allies were to continue their heavy purchases, were credit and the sale of sterling for what it would fetch in the New York market. Loans were arranged[13] in a desultory fashion but were not large enough at first to offset the increased offering of bills. Therefore the pound fell[14] steadily until in September, 1915, the British government undertook to stabilize the New York rate.

With the increasing depreciation of sterling in New York, it became more and more expensive for Great Britain to buy in the United States: for each purchase she had to pay not only the going price in the United States but also the amount of the premium on New York exchange in London. To avoid this additional expense, England stabilized the pound at $4.76 which, when increased freight and insurance are considered, was practically par. Pegging was accomplished by shipments of specie, return of American securities, sales of foreign securities in New York, and loans by the United States. Before the entry of America into the war on April 24, 1917, Great Britain arranged for the stabilization of the pound with private bankers in the United States; after the United States joined the Allies, the British government received loans from the United States government direct.

During the period from December, 1915, to April, 1917, Europe shipped $1,225,000,000 gold to the United States;[15] resold $2,000,000,000 worth of securities,[16] and borrowed $2,800,000,000 on secured and unsecured loans.[17] In addition, to help control the daily fluctuations in the market, a fund of $50,000,000 was made available

[11] E. L. Franklin quoted in Kirkaldy, *Credit, Industry, and War* (London, 1916), p. 249.

[12] The securities were later "mobilized."

[13] The advances included private credits established with New York banks and long loans such as the $500,000,000 Anglo-French loan floated in October, 1915.

[14] Depreciation of the pound sterling in New York during 1915:

| | | | |
|---|---|---|---|
| January | 4.84 | August | 4.59 |
| February | 4.80 | September 1 | 4.47 |
| March | 4.80 | " 2 | 4.64 |
| April | 4.79 | " 3 | 4.70 |
| May | 4.78 | " 30 | 4.72 |
| June | 4.76 | October 27 | 4.62 |
| July | 4.76 | December | 4.74 |

(Kirkaldy, British Finance, p. 338.)

[15] Monthly Summary of Foreign Commerce, 1914-1921.

[16] Economist (London), vol. 85, p. 1033.
Report of the Dollar Securities Committee, November 20, 1917 (House of Commons No. 212).
Investigation by M. F. Loree in Friedman, *op. cit.*, p. 353.
C. Bullock: Harvard Review of Economic Statistics, July, 1919.

[17] Kirkaldy, *op. cit.*, p. 180.

in London by the New York bankers. Large as were these funds, they began to give out in the spring of 1917. The burden of financing herself as well as the Allies was becoming increasingly difficult for England to bear.[18]

The financial history of the six months, from the end of the summer of 1916 up to the entry of the United States into the war, in April, 1917, remains to be written. Very few persons, outside the half dozen officials of the British Treasury, who lived in daily contact with the immense anxieties of impossible financial requirements of those days, can fully realize what steadfastness and courage were needed, and how entirely hopeless the task would soon have become without the assistance of the United States Treasury.[19]

Upon the entrance of the United States into the war, the United States Treasury extended credits to Great Britain and through her to the Allies. From April 24, 1917, to March 10, 1920, the advances in the case of Great Britain amounted to $4,277,000,000, in the case of the Allies together, to $9,711,000,000. To make sure that the credits would be used only for purposes deemed legitimate by the governments, all dealing in foreign exchange was licensed, and exports and imports of goods were strictly controlled.

The actual method of stabilization was the purchase and sale of British Treasury bills in the open market in New York. J. P. Morgan & Company, England's fiscal agents in New York, purchased from 1915 to 1919, £840,000,000 for the account of Great Britain, and part of the Fr. 18,000,000,000 of French exchange purchased by the Bank of France.[20] Thus, by strict control of tonnage, complete licensing of exchange dealings, and at an expense of $1,250,000,000[21] per year, Great Britain pegged the New York rate at par.

In contrast to the unvarying $4.76 to the pound sterling maintained from January 6, 1916, to March 20, 1919, are the violent and seemingly meaningless ups and downs since the date of un-pegging. Although hectic in appearance, the course of sterling rates nevertheless shows well-defined swings.[22]

With the prop removed, the influences repressed during the period of stabilization made up for lost time. Not only had Great Britain an adverse balance of $6—7,000,000,000 on her own account, but she had largely financed the imports of her allies, who owed an additional five billions to the United States.

[18] J. M. Keynes: *op. cit.*, p. 273.

[19] Keynes, *op. cit.*, footnote, p. 273.

[20] E. M. Friedman: International Finance and its Reorganization (New York), 1922, p. 377.

[21] H. P. Willis: *op. cit.*, p. 1.

[22] *Vide* Chart.

From the beginning this country has borne the whole of the expense of the supplies to all the Allied countries which were produced in the United Kingdom. Up to the time of the entry of America into the war, we also bore, in the case of some of the Allies, the whole of the expenditure outside their own country, and in the case of all of them, some portion of the expenditure out of their own country.[23]

A debtor to financially strong countries, she was a creditor to financially weak ones. Had all these debts been funded in long-term loans, they would not have come on the market in the form of a current supply of pound bills except as interest payments and would not have affected sterling exchange; however, a number of these claims of Americans and neutrals on Great Britain were in the form of short-term bills which the holders sold to obtain dollars. Exactly how many of the loans arranged between January 6, 1916, and April 25, 1917, were short-term or matured soon after March 20, 1919, it is not possible to say, since these loans were arranged privately between the British government and Morgan & Company. Of the credits established for Great Britain after the United States entered the war $4,277,000,000[24] were in notes of the British Government in favor of the United States government;[25] $91,055,000 were in treasury bills sold at the rate of seven to eight million dollars weekly and maturing within sixty to ninety days; and a considerable quantity[26] were in the form of private credits which American banks opened in favor of London financial institutions to finance exports from the United States. So far as the government credits are concerned, they have no effect[27] on exchange; the Treasury bills, in so far as they have been paid off,[28] have tended to create a demand for dollars and thus to depress the sterling rate; how far private bankers who created credits in favor of English importers have realized on their advances it is, of course, impossible to say, but to the extent that they did, their sales of pound bills depressed the London rate. In addition to the carry-over of sterling from the war period, was the supply of bills which came on the market during 1919 to finance current British trade. Though the Board of Trade estimates that, for the year 1919, Great Britain

[23] Chancellor of the Exchequer, Statement in House of Commons, July 24, 1917.

[24] In anticipation, it may be said that the bill empowering a committee of five to fund these debts has been passed.

[25] This includes United States government credits to Great Britain till March 10, 1920.

[26] The amounts here are not ascertainable but credits in fairly large amounts are known to have been arranged. Friedman, *op. cit.*, p. 362.

[27] At least not until interest payments are made which will be £50,000,000 for this year—Announcement by Chancellor of Exchequer.

[28] By December, 1920, all but $18,000,000 had been repaid. Friedman, *op. cit.*, p. 361.

had a net unfavorable balance of only £149,000,000,[29] the direction of British commerce in part accounts for the depreciation of the pound in New York. Whereas she draws the bulk of her imports from the United States, England sends the largest portion of her exports to Europe.[30] While Great Britain thus receives payment for her goods in sterling or in continental currencies, she must remit in dollars. Where the offsetting supply of New York exchange is small, as was the case in 1919, when the United States had a favorable balance of $4,328,000,000, London must bid for the available amount of New York exchange at the expense of the rate on sterling.[31]

An element of different character, though of no less importance, in the depreciation of the rate on London, is the financial situation of Great Britain during this period. Nominally, on a gold standard during the war, Great Britain was nevertheless on an inconvertible paper basis; for although redemption was not prohibited by law, it was frowned upon in practice. The rise in the market price of gold made the government very early in the war declare it illegal for any person to melt up or sell for a premium gold coins. Any attempt to obtain gold in large quantities from the Bank of England, except when authorized for export,[32] would, of course, have compelled the government to empower the Bank of England to suspend gold payments against its own notes or currency notes. "In effect, therefore, if not in name, it must be said that the gold standard has been suspended since the early stages of the war."[33] The gold production of the Empire during the war was commandeered by the Bank of England at the pre-war price of £3 s17 d9 per standard ounce. This price restriction was removed on September 12, 1919. Since then new gold from the mines has been sold in the open market to the highest bidder and re-exported subject to government license. The appreciation in the price of gold has been very material. Theoretically, and barring other influences, the premium on gold should equal the discount of sterling exchange in New York; and, in fact, the date of the greatest depreciation of currency at home is the day following the time of greatest discount of pound exchange in New

[29] The adverse merchandise balance of £670,000,000 was much larger but was offset by large earnings on shipping, investments, etc. How much of this £149,000,000 represents floating supply of bills, it is not possible to say. F. A. Vanderlip and J. H. Williams in the *Harvard Review of Economic Statistics* for April, 1920, estimate that of the total excess of exports of the United States during 1919, amounting to $4,328,000,000, $2,139,000,000 were met by United States government credits, about $1,000,000,000 by United States government purchases of European currencies, American tourist expenses, and emigrants' remittances to Europe, and only $1,307,000,000 by "uncovered exchange." To what extent this $1,307,000,000 is applicable to England is not ascertainable.

[30] From 1919 to October, 1921, the continent took 44% of the exports of Great Britain. *Journal of Commerce,* January 16, 1922.

[31] *Cf.* Commerce Reports (United States) no. 43, p. 1034.

[32] *Vide supra,* p. 21, Statement: E. L. Franklin.

[33] Kirkaldy: *op. cit.*, p. 34.

York: on February 4, 1920, sterling reached $3.18 in New York as against a par of $4.86; on February 5, 1920, gold sold for 127s 4d per ounce against the normal price of 77s 9d. The reason for this depreciation of the paper pound in terms of gold is the inflation of prices in Great Britain;[34] and this in turn is the result of the increasing quantity of currency notes and the great expansion of bank credit.[35] In view of the crisis which arose upon the outbreak of the war, it was considered necessary not merely to authorize the suspension of the Bank Act of 1844,[36] but also to empower the Treasury to issue currency notes of £1 and 10s as legal tender. The Treasury[37] undertook to issue notes through the Bank of England to bankers up to a maximum limit not exceeding for any bank 20% of its liabilities on current and deposit accounts. The amount of notes so issued was to be treated as an advance bearing interest at the current bank rate.

It is not probable that the demand for legal tender currency, anticipated at the beginning of August, 1914, would by itself have necessitated[38] a large issue of notes. But the credits created by the Bank of England in favor of its depositors under the arrangements by which the Bank undertook to discount bills of exchange, caused a large increase in the deposits of the Bank. A cause more potent than any other, however, was the need of the government for funds wherewith to finance the war. The money needed in excess of the amounts raised by taxation and by loans from the actual savings of the public, made necessary the creation of government credits with the Bank of England. The government would apply for an advance, e. g., £10,000,000 from the Bank of England which, by book entry, placed the amount required to the credit of Public Deposits in the same way as any other banker credits the account of a customer when he grants him temporary accommodation. The amount is then paid out to government creditors and passes, when the checks are cleared, to the credit of their bankers in the books of the Bank of England—i. e., is transferred from Public to Other Deposits. The effect of the whole transaction is to increase, by £10,000,000 the purchasing power in the hands of the public in form of deposits in the Joint Stocks Banks and the bankers' cash in the Bank of England

[34] *Vide supra*, p. 15: the par of exchange in a country on an inconvertible paper basis is that price of foreign currency in terms of home money which will enable purchases of equal value to be made in both countries.

[35] First Interim Report of the Cunliffe Committee on Currency and the Foreign Exchange After the War, August 15, 1918. (Hereafter, Cunliffe Committee.)

[36] Under the Bank Act of 1844 apart from the fiduciary issue of the Bank of England and the notes of the Scottish and Irish Banks of Issue, the currency in circulation consisted entirely of gold and subsidiary coin or of notes representing gold.

[37] Under the powers given it by the "Currency and Bank Notes Act," 1914.

[38] Cunliffe Committee, *passim*.

by the same amount. The banker's liabilities having thus increased by £10,000,000 and their cash reserves by an equal amount, their proportion of cash to liabilities (which was normally before the war something under 20%) is improved, with the result that they are in a position to make advances to their customers to an amount equal to four or five times the sum added to their cash reserves; or in the absence of demand for such accommodation, to increase their investments by the difference between cash received and the proportion they require to hold against the increase of their deposit liabilities. Since the war the surplus cash has, in the main, been used to subscribe to Treasury Bills and government securities. The money subscribed has again been spent by the government; it again returned to the bankers' cash balances. The process, repeated again and again, transformed the original advance of £10,000,000 to the government by the bank into new deposits representing new purchasing power aggregating several times the original sum.[39]

Before the war[40] this process, if continued, would have compelled the Bank of England to raise its discount rate to protect its declining reserve. The unlimited issue of currency notes, however, removed this check to credit expansion: increased bank deposits meant greater purchasing power, higher prices and a corresponding demand for legal tender currency. The banks instead of applying to the Treasury for an advance of Currency Notes were able to pay for them outright by the transfer of the amount from their balances at the Bank of England to the credit of the Currency Note Account. The government, by substituting its own securities for the cash balance so transferred, borrowed that balance. Fresh legal tender currency was thus continually being issued, not, as formerly, against gold, but against government securities.

Instead of resulting directly from government operations, bank credit expansion may originate with the public: for when, in buying £100 worth of government war loan, the subscriber pays up 20% and borrows the remainder from his bank, he is as truly creating inflation as though the government had borrowed £80 directly from the Bank of England; similarly if, in paying £1,000 in taxes, the business man gives £600 from his own pocket and £400 from credit advanced him by his bank, he is adding an equivalent amount to the general purchasing power.

This combined process of credits created in favor of the govern-

[39] Cunliffe Committee, *passim.*

[40] Cunliffe Committee: "Expansion of credit, by forcing up prices, involves an increased demand for legal tender currency, both from the banks to maintain their normal proportion of cash to liabilities and, from the general public, for the payment of wages and retail transactions. The demand for such currency fell on the Bank of England which, to protect its reserves, raised its rate of discount. This proved an effective means of restricting credit."

ment with the Bank of England or in favor of the public with the banks and the issue of legal tender currency based on government securities, resulted in increasing weakness in the financial and banking position of Great Britain. The Currency Note Redemption Account shows that by December 31, 1919, of the £356,000,000 notes outstanding £337,000,000 were backed by government securities.[41]

A comparison of the positions of the Bank of England just before the war began and on July 30, 1919, shows that Public Deposits had increased £3,000,000, Other Deposits £74,000,000.

Government Securities increased £32,000,000, other securities £48,000,000, or together £80,000,000. The banking reserve had fallen from 52% to 20½%.[42]

The increase in these items shows to what extent the Bank of England, mostly on Government account, had manufactured additional credit.

The full significance of the Bank of England's position appears in the combined returns of the Joint Stock Banks.[43] Their statement shows that: (1) their "credit balance" or deposit liabilities increased from £1,070,681,000 in 1913 to £2,398,831,000 in 1919, or £1,328,000,000;[44] (2) their cash reserves 271,000,000; (3) their investments 389,000,000; (4) their bills discounted 208,000,000; (5) their advances 501,000,000.[45]

Comparing the pre-war rate of increase of deposit liabilities with the growth during the war period, it is evident that the deposits of Joint Stock Banks increased seven times faster during the war than during the average pre-war year. When the basis of the increase is seen to be not the needs of industry, but borrowing on government account—i. e., on government promissory notes redeemable at some indefinite future date—the depreciation of the paper pound in terms of gold or, in other words, the rise of prices is easily explicable: to the extent that the currency note is based not on gold but on government securities, immediately redeemable in nothing at all, and that the items, Deposits and Securities at the Bank of England represent not the demands of trade, but originate in government borrowing, to that extent will the paper pound be at a discount compared to the normal pre-war price of gold.

Though the Returns of the Bank of England for February 4,

[41] Economist: vol. 92, p. 62.

[42] Economist: vol. 89, p. 204.

[43] Includes the few private banks remaining in the United Kingdom. Kirkaldy, *op. cit.*, p. 28.

[44] The pre-war rate of increase was £30,000,000 per year; the 1914-1919 rate was £221,000,000 per year.

[45] Economist: vol. 90, p. 1069.

1920,[46] showed no improvement on the position of July, 1919, the Bank took a significant step toward reducing the amount of bank credit and thus toward checking inflation by raising the bank rate to 6% on November 6, 1919. This was both a hint to the government that, now that the war was over, Bank borrowing[47] should cease, and a warning to the business community that the Bank was not willing to substitute private inflation for government credit expansion.

How much of a part short-selling played in the decline of the pound to 60% of its pre-war value, it is not easy to say;[48] certain it is, however, that shrewd speculators foresaw both the unlikelihood of Great Britain's immediately balancing her imports and exports and the impossibility of an early return to the gold standard. Therefore, though the influence of exchange transactions which do not originate in the bona-fide settling of actual business obligations, is at all times uncertain and indeterminate, it is nevertheless effective. In fact, it not only magnifies existing conditions into movements more abrupt and greater than these would, in themselves, produce, but it converts to-morrow's events into fluctuations to-day, and thus adds the uncertainties of future happenings to the confusing perplexities of present cross tendencies. Thus, while during 1919 the exchange depreciation reflected both the excess of bills coming on the market in consequence of trade obligations, as well as the inflated banking position, the zigzag downward movement mirrored also the post-war difficulties on the continent and the gloom in financial circles concerning the transition from a war to a peace basis.

With the evidence in trade statistics that, at least so far as exports and imports went, this pessimism was unfounded, and with the proof given by the raising of the bank rate to 7% on April 15, 1920, that, now that the needs of the government were less, the Bank of England refused further credit expansion and, in fact, decided to commence on a gradual process of deflation; sterling moved up from a low of $3.18 on February fourth to $4.02 on April fifth. True, this movement was largely seasonal, since it is during the January-June period that Great Britain's exports are heaviest and that bills are in greatest demand; but the rally was also due to a realization

[46] Public Deposits, £18,000,000.
Other Deposits, £124,000,000.
Government Securities, £46,000,000.
Other Securities, £82,000,000.
Economist (London), February 7, 1920.

[47] The deficit in the 1919 Budget was £326,000,000.

[48] Since the Division of Foreign Exchange of the Federal Reserve Board discontinued publication—after the close of the war—of dollar balances held in the United States by foreign correspondents, balances held abroad in foreign currencies by American Banks and business concerns, and their holdings of foreign bills and securities, no records of exchange dealings have been kept.

on the part of all who had sterling to buy that Great Britain had definitely declared herself against a policy of inflation.

Deflation, however, did not follow at once. With the business community loaned up at their banks on the basis of high-priced goods, credit contraction had to wait on liquidation. In fact, the Weekly Returns of the Bank of England on August 4, 1920, showed a weaker condition than at any time since the war; compared with July, 1914, Deposits were higher by £91,000,000 and Securities by £106,000,000; the reserve ratio had decreased from 52% to 10%. The combination of a government deficit of £326,000,000 for the year ended March 31, 1920, and the trade revival culminating about April, 1920, resulted in a demand for accommodation and the consequent manufacture of purchasing power.

In addition to the credit expansion which increased the difficulty of a return to specie redemption, the pound was at first weighed down by the demand for bills wherewith to pay the Anglo-French Loan, and later by the seasonal offering of sterling commercial bills wherewith to meet autumn exports from the United States. The loan of $500,000,000 contracted by France and Great Britain jointly in 1915 matured on October 15, 1920; for the repayment of her part of this debt Great Britain was responsible. She had to find dollar bills wherewith to meet it. Meanwhile merchants who imported cereals and cotton from the United States also competed for dollars. These influences together weighed on the sterling rate till it reached 3.34 on November 8, 1920.

As soon as the market had absorbed this supply of bills London exchange moved up; climbing slowly through hill and vale, it reached a peak of $4 on May 17, 1921. By this time the banking situation had ceased to be a cause for worry. For, though the position of the Bank of England on April 27, 1921,[49] was still far from the point of specie redemption the Weekly Returns for that date proved at least that the situation had grown no worse during the preceding nine months. A reflection of the better position of the Central Institution is the condition of the Joint Stock Banks on December 31, 1920. An increase of £150,000,000 in deposits, £140,000,000 in advances and of £75,000,000 in bills, presumably Treasury bills, is readily ascribed to expansion of trade and government borrowing in the first half of the year; on the other hand investments, probably in government securities, decreased £47,000,000 and acceptances £48,000,000. Such a showing would not excite the admiration of the conservative banker. But, comparing the Returns for the 1913-1919 period and remembering that the increase in deposits and advances resulted from financial activities in the first half of 1920 the combined position of the Joint Stock Banks emphasizes

[49] Deposits were still £85,000,000 greater than in 1914 and securities were higher by £96,000,000. Economist, April 30, 1921.

what the Bank of England statement tentatively shows: that deflation had definitely begun.

Less encouraging was the inevitable result of liquidation—reduced trade. By the middle of 1920 the effective demand for goods, repressed during the war, had about been satisfied; whereas, at the same time Great Britain had shipped as much merchandise to war-impoverished nations on credit as financial safety would permit. Trade lagged. Exports decreased with imports. While the supply of sterling which was pressed on the market for sale thus diminished with declining imports, the demand for remittances to London fell off with the lessening of British exports. Trade is the life blood of the United Kingdom. Without it Great Britain cannot exist. Before the war the Continent took the largest per cent of British exports of any of the grand divisions—37.6%. In the period January, 1919-September, 1921, Europe took 44%.[50] With the exports and imports in the early months of 1921 falling in terms of value to about half of those in 1920 it is natural that Great Britain should take a lively interest in Continental matters. Therefore, when one of the most intricate and difficult problems of post-war reconstruction, the reparations question, seemed disposed of in May, sterling rose. Traders who owed pounds in London, or speculators on the qui-vive for gain, figured that as a result of Germany's accepting the Allied ultimatum, trade would pick up again and the pound would be in greater demand. They thus hastened to buy sterling.

Much to the surprise of the Allies the actual payment of the first installment of the indemnity produced an opposite effect. Since the Reparations Commission required Germany to remit in dollars, the Reichsbank converted the Allied currencies it had accumulated into New York exchange. This created a supply of sterling which came on the market intermittently as the Reichsbank changed pounds into dollars.[51] Such was the violence of the fluctuations produced on the exchanges that the Reparations Commission later permitted the German government to remit in Allied currencies.[52] This ruling relieved the market of bills from this source.

Meanwhile the coal strike, which broke out on March 31, began to affect British trade. Added to the world-wide business depression, the stoppage of industry in England consequent on the tie-up in the coal mines, resulted in a sharp decrease of exports and an increase of imports. The world demand for sterling bills fell; London's need for foreign currencies rose. Though the miners returned to work on July first, it took some time for British trade to pick up again.

With the pound steadily declining due to Reparations payments

[50] Journal of Commerce, January 16, 1922.

[51] *Vide infra*, p. 60.

[52] Ruling by the Reparations Commission, June 26, 1921. (New York Times, June 26, 1921, 2:6.)

and the coal strike, importers who had contracted for purchases of cotton and cereals in the United States feared further depreciation and hastened to buy their dollar bills. To add to the increasing supply of exchange on London, speculators, knowing that English merchants would need dollar remittances later, sold sterling short. These forces combined resulted in a low price of $3.56 per pound on August 1.

But the bears had to cover; Germany paid partly in sterling; exports rose. The pound rallied to $4.

Instead of lapsing back, however, as it normally would, due to autumn imports from the United States, sterling rose almost uninterruptedly and reached $4.40 about the middle of February, 1922. The most outstanding feature of this steady appreciation was the continued absence of offerings of commercial bills. A carry-over of raw materials in England because of the trade depression, low prices of staples in the United States, and early covering of commitments together produced this remarkable scarcity of pound bills in New York. The shortage of London exchange is partly due also to the fact that Great Britain settled a portion of her debts to the United States during 1921 in gold.[53] Some influence may possibly be ascribed to the Washington Conference, but it can be none other than a psychological one. Its results have importance for the European exchanges only in so far as they give hope that something can be accomplished on the European continent by international coöperation.

The interpretation of the main movements in sterling exchange from March 20, 1919, to February 15, 1922, emphasizes the determining influence not only of commercial factors but also of financial forces. The trade balance produces the immediate supply or demand of bills; the condition of currency and bank credit determines the par of exchange with foreign currencies.

Different it is with the minor oscillations that go to make up the major swings. It is their function to register the bearing of political and psychological forces on the exchanges. Not that these forces would, in and of themselves, influence the rates; but where they can be translated into immediate significance for the commercial situation or banking position of a country they are as potent as the more direct factors of trade and price levels. Political and psychological influences become effective either where they cause persons who have actual debts or claims to settle, to change the time of payment, or where they induce speculators to discount future events.

A study of the more important minor fluctuations during the past year will show how complex and varied may be the concrete manifestations of the main factors. Part of the rise of $.20 in the pound from the third to the fifteenth of January is ascribed to the visit of Lord Chalmers to the United States early in the year in con-

[53] Approximately $200,000,000—Annalist, January 9, 1922, p. 45.

nection with the funding of the British debt.[54] The erratic ups ar downs during February respond to the rumors of inter-Ally debt ca cellation, American loans to Europe, the Paris Conference decisio on reparations; while the slow, steady appreciation in March was tl result of heavy American purchases of British goods in fear of tariff in the United States.[55] The fairly even oscillations betwe $3.93 and $3.89 during the first half of April reflected intermitte purchases of sterling by Americans who had imported wool in fe of the passage of the tariff bill, alternating with sales of pounds du to the anticipated effects of the coal strike. When the possible favo able effects of the reparation settlement were discounted by a ri to $4 on May 17 the pressure of the actual remittances for reparatio and for imports due to the coal strike contnued till the end of July. C August 8, sterling jumped up $.085. This sensational rise was d partly to the change in the ruling concerning reparation payments a partly to the fact that American institutions short of sterling scrambl to cover.[56] Since then the rise has been steady in consequence of lar gold shipments, scarcity of commercial bills[57] and some Americ buying of British securities. It is difficult to see how the Irish settl ment[58] can be anything more than an exceedingly vague and ind terminate influence on the rate of sterling in New York, for t economic significance of Ireland is not a very potent one in t general trade of the British Empire. Similarly "the tremendous d velopments at the Conference for Limitation of Armaments"[59] c hardly have much bearing in the rise of sterling, since the net ou come of the decisions will have no influence on trade and only a ve negligible effect on finance.

## THE FRANC.

In marked contrast to the energetic measures enacted in Lond was the attitude of resignation to the inevitable prevalent in Paris the outbreak of the war. "The French market may be said to ha given up any attempt seriously to do business."[60] On August 5, 191 the Bank of France suspended specie payments. Four days lat the government decreed the moratorium on all negotiable instrumen due between August 1 and September 1, 1914.

Despite the arrangement made by French bankers with Morg and Company about August 5th[61] for a loan for exchange purpos

[54] Bank of Liverpool and Martin's Limited, January, 1921.

[55] Barclay's Bank, April, 1921.

[56] Bank of Liverpool and Martin's Limited, September, 1921.

[57] Barclay's Bank, December, 1921.

[58] Cf. Barclay's Bank, December, 1921.

[59] New York Times, December 13, 1921.

[60] Comercial and Financial Chronicle, Vol. xcix, p. 299.

[61] Commercial and Financial Chronicle, August 8, 1914.

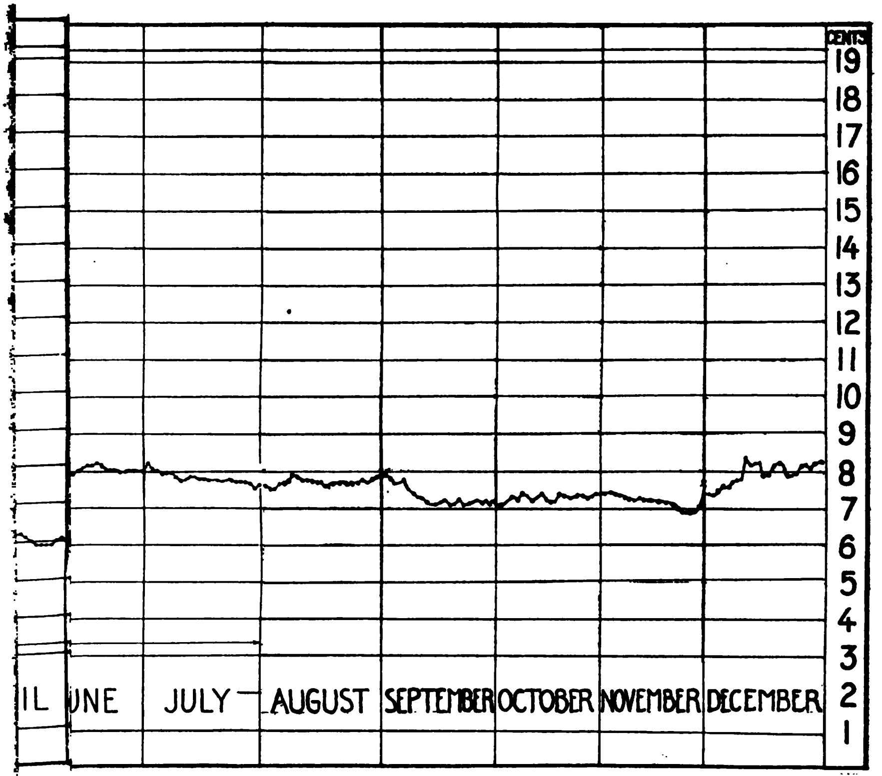
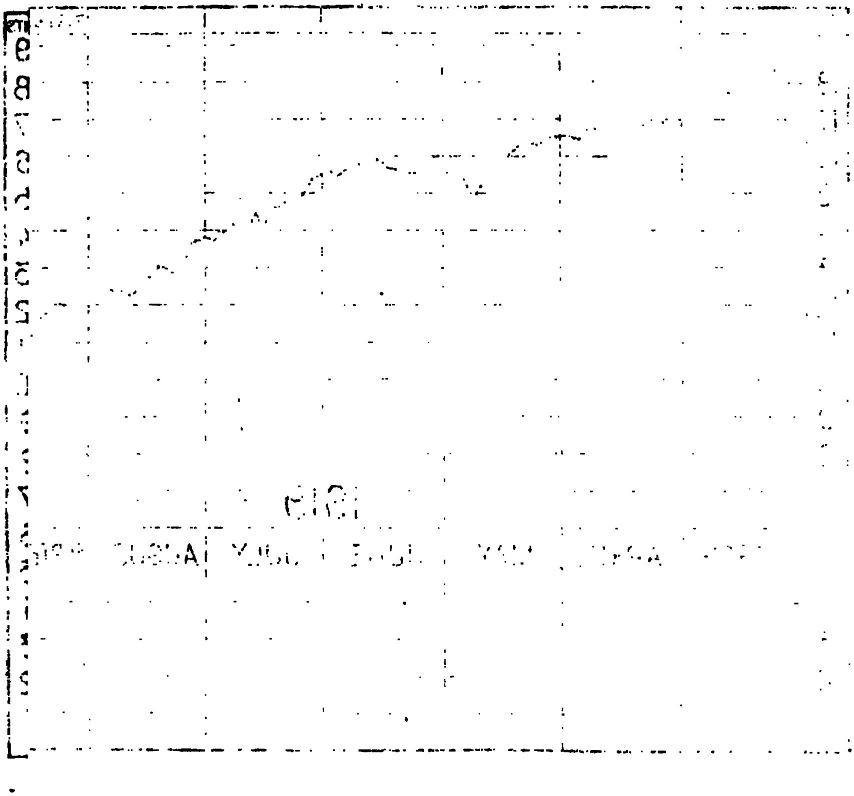



Chart for March, 1919–July, 1921.
By H. N. Lawrie,
Economist, American Mining Congress, October 1, 1921.



ıl for almost a year, it might have been argued that her trade and ːrefore her exchange would profit thereby. From the very out-ːak of the war, however, lire depreciated. By March, 1915, the lan rate was quoted at 5.79 lire to the dollar against a par of 5.18. ·rmally Italy has a debit balance in trade account which she meets tourist receipts and emigrant's remittances. When the war broke : these invisible exports ceased. Italy now had to cover her ex-s of imports by the sale of lire. During the first half of 1915, lian Exchange declined further because of the high payments Italy l to make for goods, especially cereals, imported from foreign ds.[88]

With only two interruptions the rate on Milan depreciated stead-until it touched $.111 in May, 1918. In the first months of 1916, profited by the support extended to pounds and francs in New -k. Italian exchange rose from 78% to 84%[89] of par between ·ruary and May of 1916. In 1917, when the United States entered war, the Milan rate rose slightly from $.131 in March to $.145 in -il, only to resume its decline again in May.

With the aid of the laws of November 25 and December 11, 7[90], and the arrangement of the Italian government with the United tes Treasury in May, 1918,[91] Italian lire were finally stabilized at 57 or 81.4% of parity. To peg Italian exchange, the National In-ute bought 6,000,000,000 lire between December 25, 1917, and ·y 13, 1919,[92] between March, 1918, and March, 1919, the United ·tes Treasury lent Italy $1,660,000,000.[93]

On March 21, 1919, the support of lire in New York was modi-l and shortly thereafter abandoned. The Federal Reserve Board

[88] Economist (London), Vol. lxxx, p. 751.

[89] Percentages are taken from the Federal Reserve Bulletin.

[90] November 25, 1917, No. 1900 (Minister of Treasury, Nitti): was the first ːasure to restrict free dealings in the exchange. It, however, preserved free mpetition between banking houses interested therein. The decree specified what transactions securities might be sent abroad, and foreign credits sold, d prohibited all sales of bills of exchange not drawn with one of the follow-; objects: (a) payment of goods about to be imported with the consent of : Government; (b) settlement of debts due; (c) remittances for the main-ance of persons resident abroad and possessing property in Italy.

December 11, 1917, No. 1956 (Minister of Treasury, Nitti): instituted a nopoly of trade in exchange and provided for the creation of the National ;titute with the object of exercising such monopoly. The former provisions ,erning the legality of the sales of foreign bills were left practically intact. however, added the further restriction that no liability for payment should contracted without the previous consent of the Institute. However, even -ing the system of monopoly, Italian banks which were constrained to act agents of the Institute, maintained their relations with foreign banks. conomic Review, Vol. ii, p. 410, 1920.)

[91] Bonaldi Stringher: Sulli condizioni della circolazioni e del mercato mone-io durante e dopo la guerra. (Economic Review, vol. ii, p. 410.)

[92] Il Sole, August 18, 1920.

[93] Report of the Secretary of the Treasury, 1920, p. 54.

hopeless for Great Britain alone to continue financing her Allies, the United States, upon her entrance into the war, supplied them with abundant credit. By November, 1918, when the belligerents signed the Armistice, France had borrowed from the United States Treasury $2,550,000,000.[65] To stabilize the Paris rate the Bank of France bought, between 1915 and 1919, 18,000,000,000 francs.[66]

On March 18, 1919, Great Britain "unpegged" exchange on France. No longer upheld by artificial measures the franc now responded to all the adverse commercial and financial forces. France accumulated an excess of imports of 62,000,000,000 francs between 1914 and 1918. During the first year after the cessation of hostilities, she added 23,920,000,000 francs to the claims already outstanding against her as a result of the war. To meet this enormous indebtedness, she borrowed 23,892,000,000 francs in the form of foreign short-term obligations and sold a large amount of her money abroad. Since at any time after the release of the peg, the holders of these unfunded claims might wish to convert them into their home currency, this floating indebtedness exerted a constant pressure on the franc.[67]

Before the war France could meet her adverse merchandise balance by invisible items. Not only did she lose most of these as a result of the war but her enormous foreign debt which she contracted during the war, substituted invisible imports for her pre-war invisible exports. Before 1914, 40,000,000,000 francs of French capital was invested abroad.

Between 1914 and 1919, France advanced her Allies 13,617,000,000 francs.[68] Her total claims against foreign countries amounted to 53,617,000,000 francs in 1919. Against these France incurred a debt abroad of only 33,000,000,000 francs. If these debits and credits were equally secure and equally liquid, France would still enjoy an invisible net favorable balance of over 1,000,000,000 francs. Her claims, however, are against financially weak countries such as Russia, Austria, and the Balkans; her debts, on the other hand, are to strong nations such as Great Britain and the United States. The result is that while France must meet her foreign obligations as they fall due, her own capital is tied up for years to come. On January 15, 1920, France had to repay £6,760,000 in London by the purchase of sterling bills in the open market.[69] Meanwhile, the 40,000,000,000 francs invested in Russia, Austria and the Balkans

[65] Does not include the credit of $1,025,000,000 which was made available to the French government between January, 1918, and November, 1920, for the American Expeditionary Force. Report of the Secretary of the Treasury, 1920, p. 54.

[66] Friedman, *op. cit.*, p. 377.

[67] Cf. Bank of France report. Economiste Français, April 2, 1921.

[68] Friedman, *op. cit.*, p. 168.

[69] Journal des Débats, January 19, 1920.

ɜld no offsetting return. The double need of settling for an excess merchandise imports and of meeting the invisible items in her ıde balance, was a powerful influence in the decline of French ex-ange from $.1835 on March 18, 1919, to $.0590 on April 27, 1920.

Had France incurred these obligations abroad without at the me time inflating her currency, it is doubtful whether the franc ould have depreciated to so low a level. The suspension of specie yments on August 5, 1914, and the subsequent issue of legal tender tes, placed France on an inconvertible paper standard. Since the vernment relied on the manufacture of bank credit rather than on xation[70] to finance the war, the Bank of France had to furnish the easury with funds. The method was extremely simple: the Bank scounted government paper and gave Treasury notes in return. The tes the government passed out to its creditors in payment for goods d services. The process is merely a simpler version of the British ethod.[71] To what extent the creation of credits in favor of the reasury weakened the position of the Bank of France, is evident om its comparative returns in July, 1914, and December, 1919:

(1) Metallic Reserve increased 1,689,000,000 francs.
(2) War advances to the government totaled 25,500,000,000 francs on December 26, 1919.
(3) Loans, discounts and advances rose 452,000,000 francs.
(4) Deposits increased 2,552,000,000 francs.
(5) Notes in circulation totaled 37,274,000,000 in 1919 against only 5,714,000,000 francs in 1914.

Even though overcautious in granting accommodations, the pri-e banks did not escape the effects of inflation.

(1) "Cash" increased from 471,000,000 francs in December, 31, 1913, to 1,064,000,000 in 1919.
(2) Bills discounted rose from 3,494,000,000 francs to 8,299,-000,000 francs.
(3) Debits in current account were 1,464,000,000 francs in 1913 and 2,581,000,000 francs in 1919.
(4) Deposits rose from 5,138,000,000 francs to 11,455,000,000 francs.
(5) Acceptance liabilities declined from 493,000,000 francs in 1913 to 172,000,000 francs in 1919.

All the items, with the exception of acceptance liabilities which resent purely trade demands, prove the influence of government

[70] Laughlin, *op. cit.*, ch. iv.
[71] *Vide supra*, p. 25.

manufacture of credit. The inevitable result was depreciation of t paper franc. Since trading in gold was prohibited during the w: there was no official recognition of the premium on specie. In 19: the government removed this restriction. The kilogram was woı 11,200 francs or 3.26 times parity on May 5, 1920. On the same d francs in New York had declined to 31% of the pre-war level.

Apart from these direct factors, there are the anticipations which speculation is influenced. Upon the release of the "peg," forei exchange operators knew that the combined effect of a depreciati currency and continuing adverse trade balance would drive francs i below $.1835. Without waiting for these forces to manifest the: selves directly, they sold francs short. In this way they discount the effect of elements which otherwise would have operated mc slowly.

Not only did they hasten the depreciation of French Exchan but they intensified the downward movement. At $.0595 to the fra: all those who had bills on France to buy, tried to fill their commitmeı as quickly as possible. Attracted by the low price of francs, spe‹ lators bought for a rally or covered short contracts.

Meanwhile the actual trade situation in France warranted 1 belief that imports would diminish. The excellent grain crop of 19 permitted France to reduce her imports of cereals.

Notre récolte de céréales s'announce excellente. Il est probable c nous n'aurons que peu de grain à acheter au dehors. Pour se ren‹ compte de l'importance de ce facteur, il suffit de se rappeler qu'en 19 nous avons importé pour 2 milliards 350 millions de céréales et de farin‹ encore ce chiffre—calculé d'après les valeurs de 1918—est-il inférieur beaucoup à la réalité. Sur le marché des devises, les perspectives d'une mc son abondante se sont dès à présent traduites non seulement par les espo qu'escompte la spéculation, mais par des réaltiés: on assure que de gran‹ quantités de change, qui avaient été achetées en prévision d'ımportatic de grain, ont été revendues ces derniers temps.[72]

Not only the volume of imports but also the price of commodit bought abroad decreased and, to that extent, reduced the amount foreign currencies importers had to buy. At the same time that 1 food situation warranted a reduction of imports, France was able increase sales of her goods abroad. Between January and May expo trebled in comparison with the same period in 1919.[73]

Invisible export items during this same period increased. T influx of foreign tourists created a demand for francs which offset a great extent the adverse merchandise balance.

[72] Temps, June 23, 1920.

[73] *Vide* Table X, p. 161.

Un autre élément, dont nous avons maintes fois montré l'importance, au point de vue du change, est la venue des touristes étrangers. Ceux-ci affluent depuis quelques semaines, et les fonds qu'ils apportent dans notre pays comblent une partie de moins en moins négligeable du déficit de notre balance commerciale. Les achats qu'ils vont faire promettent d'être considérables. Cette "exportation sur place" s'ajoutera aux expéditions de marchandises au dehors, qui apparaissent seules dans les statistiques douanières.[74]

Examination of the monetary condition shows that the Bank of France tried in every way to limit the further expansion of credit. On April 8th, the Board raised the discount rate which had remained at 5% since August 20, 1914, to 6%. On April 14, the Directors succeeded in arranging with the Minister of the Treasury to reduce the advances of the State by 2,000,000,000 francs by December 31, 1920.[75]

Indirect influences of a political rather than an economic and financial nature contributed to the appreciation of the Paris rate. The prospect of a favorable settlement of the reparations problem influenced traders in foreign exchange. "En dehors de ces facteurs réels qui ont contribué à l'amélioration de notre change, il y a les prévisions qui déterminent l'action de la spéculation. Dans cet ordre d'idées, la première conférence de Hythe a joué un rôle certain. Des résultats favorables avaient été escomptés."[76]

Between March, 1919 and April, 1920, francs declined because of the adverse trade balance of 1914-1919, the internal depreciation of the franc due to credit expansion, and the activities of speculators who discounted these factors, as well as the uncertainties of the political and industrial condition. By the same token francs rose between April and June of 1920: the adverse trade balance was decreasing, the Bank of France took steps to limit inflation, and the exchange market saw less gloom in the international situation.

At a price of $.084 to the franc, Paris exchange was subject to pressure both from Frenchmen who had waited to make remittances abroad and from foreigners who might take advantage of the rise to dispose of some of their franc holdings.

On se trouve donc exposé à un double risque. Les étrangers qui avaient acheté des francs au moment où ils étaient coté plus bas peuvent les revendre pour réaliser un bénéfice, c'est-à-dire venir nous retirer des fonds. Les commerçants français peuvent également vouloir profiter de l'amélioration des cours du change pour effectuer les règlements qu'ils ont différés et qu'ils ne peuvent pas d'ailleurs ajourner indéfiniment. Et il n'est pas douteux que les uns comme les autres ne manqueront pas d'opérer dans ce sens dès qu'ils verront que le mouvement de baisse des changes

[74] Temps, June 30, 1920.

[75] Bank of France Report, 1920. Economiste Français, April 2, 1921.

[76] Temps, June 23, 1920.

étrangers est arrêté sérieusement. De même que personne ne veut plus vendre tant que les cours reculent, tout le monde se précipite pour acheter quand ils remontent. C'est l'éternelle histoire des moutons de Panurge, qui est la règle du jeu en matière de spéculation, et l'on sait si la spéculation est pour quelque chose dans les fluctuations du change.[77]

Speculation alone is, however, powerless to influence exchange for any length of time. It is only the actual balance which must be settled that can effect the rate permanently.

With every rise in the price of francs, the possibility that the short-term debt inherited from the war, the 21,000,000,000 debit balance for 1919, and the 7,000,000,000 for the first half of 1920 would come on the market increased.

Les dépôts de francs que l'étranger a transférés dans nos Banques constituent, en quelque manière, une dette flottante, dont les variations se répercutent sur le marché des changes.

Ces dépôts donnent lieu, en effet, suivant l'orientation de l'opinion à l'étranger, à des afflux capitaux, ou, au contraire, à de brusques retraits auxquels il convient d'attribuer, pour une très large part, les fluctuations violentes que subit par instants le cours de notre monnaie.[78]

The repayment of France's share of the Anglo-French loan on October 15, added its quota to the supply of francs already on the exchange market. To cover the $250,000,000, France borrowed $100,-000,000 in the United States, sent $20,000,000 gold and bought bills on New York to meet the difference.[79]

Le règlement a été assuré par un nouvel emprunt de 100 millions de dollars aux Etats-Unis, par l'envoi de 20 millions de dollars d'or que la Banque a mis à la disposition de l'Etat, et, pour le surplus, par des achats de change qui ont contribué à déprimer le cours de notre devise.

On trade account, France had a net debit balance for 1920 of 13,000,000,000 francs. Compared with pre-war figures, this is still a stupendous obligation; but considering the 1919 deficit of 22,000,000,-000 francs, it proves that France was at least reducing her adverse balance of indebtedness.

The gains in the commercial condition are in a certain measure neutralized by the monetary situation. Despite the rise in the discount rate and the agreement with the government concerning the limitation of advances to the State, inflation did not cease. The banking position in December was, if anything, weaker than in January, 1920. Because of the large budget deficit of 35,000,000,000 francs the Board

[77] Journal des Débats, May 17, 1920.
[78] Bank of France Report, 1920.
[79] Bank of France Report, 1920.

of Directors of the Bank were compelled to allow the Government an extension of one year to fulfill its promise of paying back loans.

Votre Conseil a donc été amené, à la date du 14 avril dernier, non sans élever la plus énergique protestation, à proroger, jusqu'au plus prochain emprunt, et au plus tard jusqu'au 31 décembre 1921, le delai précédemment fixé pour ce remboursement extinctif.[80]

Expressed in statistical form, the result of this delay on the part of the government in fulfilling the agreement was that:

(1) Metallic reserve in the Bank of France decreased 79,000,000 francs.
(2) Advances to the government increased 1,100,000,000 francs.
(3) Loans, discounts and advances increased 28,000,000 francs.
(4) Notes in circulation increased 688,000,000 francs.
(5) Deposits increased 391,000,000 francs.

In addition to the notes of the Bank of France, the large floating debt is a dangerous element in the inflation of the currency.

Mais il reste toujours en circulation 37 milliards et demi de billets de banque avec cours forcé,—chiffre inférieur de quelques centaines de millions seulement au maximum atteint en mars dernier et supérieur de 7 milliards à celui enregistré au moment de l'armistice. Il reste, de plus, une dette intérieure flottante d'environ 50 milliards qui ne constitue pas seulement une circulation supplémentaire "en puissance" mais dont les titres sont effectivement employés, dans bien des cas, comme instruments de payement.[81]

The decline of the franc from $.084 on June 22 to $.0572 on November 11, 1920, registered the balance of foreign indebtedness overhanging the exchange market as well as the inability of the Bank to put a definite stop to inflation.

Just as exchange traders were trying to find a quotation which would both adjust the inflated price level in France to world values and absorb the large supply of bills and currency resulting from the excess of imports, commercial and financial conditions in France began to improve. In the first six months of 1921, France actually had a net surplus of merchandise exports of 392,000,000 francs. Though but a drop in the ocean of foreign obligations, these few millions of claims on other countries helped to reduce France's debts to other nations. At the same time the excess of exports proves that France is approaching a point where she will buy abroad no more than she can pay for.

[80] Bank of France Report, 1920.
[81] Temps, June 30, 1920.

While the business men of France were raising exports to meet imports, the Board of Directors of the Bank were beginning to realise their long-cherished hope: the Government commenced to pay off war advances; the Conseil was able to reduce note circulation. The statement of the Bank, as of June 23, 1921, shows a situation which is perhaps not ideal from the point of view of the more severe deflationists, but which nevertheless proves that, so far as the Bank of France is concerned, further inflation has ceased.

(1) Metallic reserve increased 24,000,000 francs.
(2) War advances were reduced by 1,400,000,000 francs.
(3) Loans, discounts and advances decreased 325,000,000 francs.
(4) Deposits declined 748,000,000 francs.
(5) Note circulation fell 403,000,000 francs.[82]

Important above all things during this period is the settlement of the Reparations problem on May 1. Every money payment to France reduces her budget deficit and, to an equivalent amount, enables the Government to reduce Bank advances; every delivery in kind hastens the rebuilding of the North and East, and to that extent strengthens her exporting power. The equalisation of her exports and imports, her stand against inflation, the prospect of covering her excess expenditures by receipts from Germany, combined to raise the value of the French franc from $.0595 in January to $.0881 on May 21, 1921.

The actual payment of the first installment of the indemnity produced an effect on francs similar to the depreciating influence on sterling. By converting francs into dollars, as the Reparations Commission demanded, the Reichsbank threw French franc bills on the market. Inevitably French Exchange declined.

Die deutsche Devisenbeschaffungsstelle entledigte sich zwar dieser Aufgabe (in Dollars zu zahlen) durch Umtausch der nicht gewünschten Valuten in Dollars im In- und Ausland in kürzester Zeit, aber unter dieser Transaktion litt ganz besonders der Kurs der Ententemächte in New York. Die Zwangsvorschrift der Reparationskommission hatte dem Dollar eine derartige Vorzugsstellung geschaffen, dass die Stärkung der Ententevaluten gegenüber der deutschen Valuta, die ja durch die Sanktionspolitik minder schwer ins Gewicht fiel, keinen Ausgleich für den Rückgang der eigenen Valuta in New York schaffen konnte. In den Tagen jener Devisentransaktion der ersten Junihälfte fiel der Devisenkurs Paris in New York von $.0847 am 1. 6. auf $.0826 am 3. 6. und weiter auf $.0786 am 9. 6.[83]

[82] *Vide* Table VI, p. 157.

[83] Karl Montanus, Hannoverscher Kurier, Handels- und Wirtschafts-Beilage, August 19, 1921.

In so far as the German payments did not cover the full amount the French expenditures, the Government had to borrow to meet budget deficit. Since, by agreement with the Conseil, the Treasury l to refrain from resorting to bank advances, it issued short-term igations direct to the public mainly in the form of National Defense nds. These are taken up for the most part by agriculturists who isider them as bank notes bearing interest and with whom they ve currently as money. They are thus a potential element of inflan.[84] How important and dangerous a factor these short-term obliions are, is evident from the fact that from December, 1918, to cember, 1921, they rose from 22,335,000,000 francs to 63,700,000,) francs. The enormous increase of 41,365,000,000 francs proves t where the Government can not meet its expenditures by taxes or ns from the actual savings of the people, it must borrow from the ık or from the public. In either case inflation results. Acting toher, the pressure of reparations payments, the difficult budget sition, and the ever-present floating indebtedness[85] drove francs down $.0690 on September 17, 1920.

The forces swaying French Exchange during this period were t, however, uniformly unfavorable. Realising the folly of its former gulation, the Reparations Commission now ruled that Germany be mitted to pay in Allied currencies. This decision coupled with the er-improving merchandise trade balance relieved the Exchange mar: from the Reichsbank's supply of francs at the same time that offers of commercial bills became scarce. For the ten months ending tober 31, 1921, France's adverse merchandise balance was only -90,000,000 francs. Invisible items, such as tourist expenditures d return on capital invested abroad easily wipe out this debit on de account. With the market relieved—at least temporarily—of supply of bills representing the excess needs of importers, traders d only to take into account the monetary and political situation.

Whereas French Exchange is, at present, free from the depreting force of a current surplus supply of trade bills, it is neverthes burdened by the leaden weight of previously accumulated floating lebtedness, by the inflationist practices of the Government, and by continuing uncertainty in the Reparations problem.

While the major swings of the franc respond to the commerl and financial forces and to those political factors which have an portant bearing on economic conditions, the minor oscillations reflect ose multitudinous happenings which a speculative market translates to significance for the exchanges. The formation of a new cabinet der Briand and the prospect of a settlement of the German indemnity

[84] Journal des Economistes, December, 1921.
Journal of Commerce, February 17, 1922.

[85] Estimated at 10,000,000,000 francs on December 31, 1921. Wall Street urnal, January 3, 1922.

goods.[125] By this measure Germany instituted a system of licensing exchange transactions virtually similar to that of the Allies.

To render this control more effective, the Government, in January, 1917, issued orders which prohibited the general importation and exportation of goods except by permission of the Imperial Commissary Department. A decree of February 8, 1917, required the sanction of the Reichsbank for remittances to foreign countries of bills payable in marks and for incurring liabilities in foreign currency.[126]

This strict system of regulation did not, however, result in pegging the Berlin rate; for Germany lacked the principal means of making this control effective—credit. Though she was able to obtain scattered and intermittent loans from Switzerland and the Scandinavian countries, she had no constant, ever-replenished fund to rely upon. With Switzerland she arranged for advances proportionate to the quantity of coal she could send: in addition to paying for the fuel, the Swiss firms had to give notes, the proceeds of which Germany received against the deposit of securities. By 1919 Germany's total debt to Switzerland was 350,000,000 gold marks. From the Scandinavian countries, the Central Empires borrowed on similar terms. To furnish credit for purchases in Norway under special trade agreements, a syndicate headed by the Deutsche Bank and the Norges Bank arranged a loan for Germany in return for coal and other essentials.[127] The utmost that these small driblets of credit could accomplish was to let Germany have badly-needed commodities without giving rise to a corresponding supply of bills. To the extent that these loans enabled Germany to obtain goods without immediate payment, the arrangements relieved the mark from pressure; but the advances were by no means large enough to maintain the rate near par or to prevent oscillations. In a zigzag course, Berlin exchange pursued a general downward trend punctuated by political events. At the entry of the United States into the war in April, 1917, marks stood at 75% of par; upon America's joining the Allies, German exchange fell from $.17 to $.12 within two months. After fluctuating about this level during the remainder of 1917, the Armistice with Russia and the Treaty of Brest-Litovsk, combined with the successful German Offensive, relieved for a time the pressure on marks and Berlin Exchange rose to 70.3% of parity in February, 1918. With the reversal of military fortunes, on the

[125] Friedman: *op. cit.*, p. 479: Deutschlands Finanz- und Handelsgesetze im Kriege. Gesetze, Verordnungen und Bekanntmachungen aus dem Bank-, Börsen, Devisenverkehr, Währungs-, Finanz- und Steuerwesen, Handels-, Wechsel- und Scheckrecht in Deutschland während des Krieges, by Joh. Notzke, Librarian of the Reichsbank (Berlin, 1917). Interview with Herr Ludwig Bendix, Chief of the Foreign Exchange Bureau of the Ministry of Commerce. Reported by Consul Frederick Simpich, Berlin, July 31, 1920.

[126] Kölnische Zeitung, August 5, 1917.

[127] Tidens Tegn, September 15, 1918.

other hand, the monthly averages declined, until in December, 1918, the mark stood at 48.6% of parity.

Although German exchange fell continuously during the war, the repeal of the Devisenordnung, on September 15, 1919, had almost as great an effect on the Berlin rate as the release of the peg had on the Allied exchanges. Practically, the only point of difference was that the German rate did not have so far to fall.

While the Allies were piling up a huge excess of imports during the war, Germany, because of the blockade, had not such a large adverse trade balance. When, however, in 1919, the Allies removed the restrictions, imports made up for lost time. Long deprived of essentials and hungry for the luxuries of pre-war days, the people imported tremendous quantities of goods.[128]

Although the German Government still maintained and vigorously enforced trade restrictions, illegal imports, through the "hole in the West," ran into the billions. "The sovereignty of the German Commonwealth on its frontiers was eliminated and it has had to look on, while against its will, *articles de luxe*, to a value of milliards of marks, have been poured into the country."[129] At one coup, the government confiscated 11,000,000 marks of goods. "The government is meeting with much difficulty in enforcing its import and export control regulations. Not long ago 11,000,000 marks' worth of merchandise, for the importation of which proper documents had not been taken out, was confiscated at one of the government's 'catching places.'"[130] Foreign cigarettes alone, to the value of several milliards of marks, entered Germany through the "gap in the West."[131] The consequence of this unprecedented inflow of goods was an adverse merchandise trade balance estimated at 20,000,000,000 marks.

As an offset to an excess of imports of 1,600,000,000 marks in pre-war years, Germany had an invisible income of 3,200,000,000 marks.[132] Due to the Peace Treaty, however, Germany lost her merchant marine, surrendered valuable territory as well as her colonies, and lost her property in foreign countries. Germany could no longer

[128] The exact figures are not published; estimates place imports to exports ratio 300-400%.
J. Wolfe: Finanz- und Volkswirtschaftliche Zeitfragen, Vol. lxix, p. 40.

[129] Kölnische Zeitung, February 22, 1920.

[130] Consul F. Simpich: Commerce Reports, July 13, 1920.

[131] Frankfurter Zeitung, August 20, 1920.

[132] Interest on investments of 35,000,000,000 marks amounted to 1,700,000,000 marks. Earnings on shipping totaled 1,000,000,000 — 1,500,000,000 marks.
Friedman, *op. cit.*, 451.
*Cf.* Keynes's estimate of investments of 25,000,000,000 marks. (J. M. Keynes, The Economic Consequences of the Peace, p. 175.)
Hans David, Weltwirtschaftszeitung, June 13, 1919, gives the figure *as 21,000,000,000* marks.

balance an excess of merchandise imports by credits arising from non-goods transactions. On the contrary, the post-war period developed conditions which produced enormous invisible imports. As a result of the military collapse, foreigners in the neutral countries, Alsace-Lorraine, and the other Central Powers, sold their marks.[133] Foreign countries at the end of 1919 held 20,000,000,000 to 25,000,000,000 marks. As mark values day by day melted away, merchants of neutral countries who held German currency obtained near parity, converted into home money to avoid wasting of their assets: "during the past eighteen months, Germany's payments have been largely effected by the sale of Reichsbank notes in foreign countries and by shouldering of large, fresh liabilities in foreign currency."[134]

Not only did foreigners change their mark holdings into foreign currencies, but Germans themselves made all possible efforts to obtain non-German exchange. Upon the announcement from Weimar that on July 23, 1919, "all current German paper would be replaced by bonds or emergency paper in order to determine how much property is available in Germany for inevitable taxation," marks dropped from 33% of par in July to 19% in September.

Wealth fled the country. Such was the exodus of all forms of capital that the government abandoned the Weimar plan.[135] Nevertheless, it was increasingly evident that, whether by this or some other method, Germany would have to tax herself ruthlessly. The budget deficits coupled with the Treaty requirements imperiously demanded new sources of revenue.[136] Afraid of heavy increases in taxation, German capitalists continued to convert their money into foreign currency; German exporters kept their payments for their goods in foreign currency in banks abroad and thus deprived the German importers of the means of liquidating their debt.

"Dazu (passive Zahlungsbilanz) kam aber, dass selbst für diese schmächtige Ausfuhr nur zu einem Teile Zahlung ins Inland geleistet wurde, zum anderen Teile aber die erworbenen Gegenwerte draussen stehen blieben. Von seiten der Exporteure wurden auf diese Weise Guthaben im Auslande angesammelt, sei es für geschäftliche Zwecke, sei es um sich vor Steuern zu drücken.

Nicht zuletzt trat aber zu dieser mit dem regelmässigen Geschäftsgang verknüpften Auswanderung von Geld die eigentliche Steuerflucht von Inlandskapital ins Ausland in Zusammenhang mit der kapitalsfeindlichen Steuergesetzgebung. Zu Lande, zu Wasser, in der Luft wurde Kapital ins Ausland gebracht. Ententeangehörige gaben sich dazu her, auch andere

[133] Estimate by Dr. Calmon, Assistant Director of the Darmstädter Bank. Friedman, *op. cit.*, p. 452.

[134] Commerce Reports, March 19, 1920. Kölnische Zeitung, February 22, 1920.

[135] Algemeen Handelsblad, November 2, 1919.

[136] Wolff: *op. cit.*, Vol. lxix, p. 40.

Reisende, die Grenzbevölkerung und, wie es heisst, zum Teil auch fremdländische oder deutsche Zollorgane. So wanderten ungeheure Massen deutscher Kapitalien in die Fremde.

Das war eine Häufung von der Mark abträglichen Momenten — man darf schon sagen eine fast abenteuerliche Häufung im Rahmen der Zahlungsbilanz, die eine geradezu zermalmende Wirkung auf die Mark nicht verfehlen konnte. So ist es gekommen, dass ihr Wert bis auf 5½ Ctms., das sind 4½% des Friedenswertes, zusammenschmolz."[137]

As in the Allied countries so, too, in Germany, inflation was at least as potent a cause of exchange depreciation as the adverse trade balance. Upon the outbreak of the war, emergency legislation[138] suspended specie payment: the Reichsbank notes were no longer redeemable in gold; the treasury was released from the requirement of redeeming its notes and subsidiary coins in gold; the private issuing banks were allowed to redeem their notes with Reichsbank notes. These measures effectively placed Germany on an inconvertible paper basis.

Once off the gold standard, the temptation of overissue was irresistible. In fact, Germany relied on the creation of currency and notes to finance the war. As in England, the government put out notes called *Reichskassenscheine*[139] to provide media of small denominations. For the rest, the treasury called on the Reichsbank[140] to supply it with funds. "As the other sources of credit were in part rarely in a position to grant new credit, in part completely unable to do so, the general and pressing need for credit was forced to seek its satisfaction in the Reichsbank as the final source of credit in the country."[141]

The banking law of March 14, 1875, required one-third cash, a limited amount of Imperial Treasury Notes, and two-thirds commercial paper as backing for Reichsbank notes. Since the amount of gold and commercial bills was limited, the Bank had to find new kinds of cover. Imperial Treasury Notes and *Darlehnskassenscheine*[142] advanced to the status of "cash"; treasury bills[143] were decreed legal substitutes of commercial bills. With the help of these measures, Germany could not create new credits in favor of the government and, at the same time, supply the business world with legal tender. The Reichsbank statements show to what extent the government resorted

[137] Wolff: *op. cit.*, Vol. lxix, p. 40.

[138] Ludwig Bendix: "Germany's Financial Mobilisation," Quarterly Journal of Economics, Vol. xxix, pp. 728-745.

[139] Reichsgesetzblatt, Germany, 1914, p. 347, Law 4448, sections 1 and 2.

[140] Journal of Political Economy, Vol. xxix, pp. 513-547.

[141] Report of Reichsbank, 1914, translation in Bankers' Magazine, London, October, 1915, p. 515.

[142] Reichsgesetzblatt, Germany, 1914, pp. 340-345, Law 4446.

[143] *Ibid.*, p. 327, Law 4435.

o advances from the Bank, both during the war and after the armis-
ice

From 1914 to 1918 the government used its credit-manufacturing power with comparative restraint. Bank Notes rose 856% or from 2,303,000,000 marks on December 31, 1913, to 22,188,000,000 marks on December 31, 1918; commercial and treasury bills increased 18.4 times, from 1,168,000,000 marks to 27,416,000,000 marks; the ratio of metallic reserve to notes in circulation and deposit liabilities, declined from 45.2% on December 31, 1913, to 11.4% on December 31, 1918. Inevitably the position of the leading German banks as of December 31, 1913, and December 31, 1918, reflects the condition of the Reichsbank. Whereas cash increased from 355,000,000 marks to .,473,000,000 marks, bills, "including Treasury Bills," rose from .,766,000,000 marks to 11,281,000,000 marks; deposits only from ?,853,000,000 marks to 9,274,000,000 marks.[144]

The inflationary effect of this output of paper money was not serious: prices by 1918 had risen only 233%.[145] It was after the armistice that the government made the greatest demands on the Reichsbank; it was when the war had ended that German currency depreciated with greatest rapidity. In little over a year, from November, 1918, to December, 1919, Reichsbank notes increased by as great an amount as during the entire previous four years: whereas in the 1914-1918 period, the increase was from 2,303,000,000 marks to 16,959,000,000 marks on November 7, 1918, the value of notes on December 31, 1919, amounted to 35,698,000,000 marks. The basis of this rise in circulation was an increase in bills discounted of 22,-000,000,000 marks for 1919 against an increase of 18,000,000,000 marks between December 31, 1913, and November 7, 1918.[146] The ratio of metallic reserve to notes and deposits in 1919 had fallen to 2.6%, barely one-fourth of the 1918 figure. As a result of this weakened condition of the Reichsbank, the items "cash," "bills," and "debits in current account" in the leading German banks practically doubled.[147] Since in the item "bills" are merged both commercial and treasury bills, it is impossible to know the exact extent to which government notes displaced business paper. It is probable, however, that the combined item consists chiefly of treasury bills. This large increase in circulation soon reflected itself in the value of German currency. During 1919, prices rose as much as during the entire war

[144] Federal Reserve Bulletin, October, 1920, p. 1049.
[145] Statistisches Jahrbuch (Berlin, 1919), Sec. ix.
[146] *Cf.* V. Scheel, Deutsche Wirtschaftszeitung, March 1, 1920.
[147] Federal Reserve Bulletin, October, 1920, p. 1049.

period. Though inflation continued steadily during 1914-1918[148] the German government did not recognize the depreciation of the gold mark until 1919. In that year, "by stipulating that customs duties must be paid in gold at a ratio of 2½ paper marks to 1 gold, the government officially admitted for the first time that the mark then in circulation could no longer be considered a gold mark."[149]

Beside the supply of marks due to the trade balance and the adjustment of German prices to world values, social and political forces caused sharp though temporary movements in bills on Berlin. In the post-Armistice days every political, every social event, had economic significance. The uncertainty of the Reparations, internal disorders, the fear of change in government—all these, "bear" speculators translated into mark quotations. As a result of the Sparticide revolt in the early part of November, 1919,[150] marks dropped ten to twenty points in one day. The depreciation for the first two weeks of the month amounted to 30%.

Weniger freilich die Demokratie an sich als ihr sozialistisches Kolorit dürfte beim Kurssturz von 1919 mitgewirkt haben. Eine sozialistische Demokratie wird natürlich von den Bourgeois der benachbarten Länder anders angesehen, als eine kapitalistische Demokratie es würde. Dazu kamen die mannigfachen Gewaltakte, der da und dort aufflackernde Bürgerkrieg, wenn er auch Guerillakrieg blieb. Ob der Putsch von rechts oder von links ausging, ob es Revolution oder Konterrevolution war, war dabei verhältnismässig gleichgültig. Bald fürchtete das Ausland mehr den Militarismus bei uns, bald mehr den Bolschewismus. Doch wurden die sich aus solchen politischen Episoden ergebenden Folgen für die Valuta im ganzen rasch überwunden.[151]

The unprecedented decline in mark exchange from $.035 in July, 1919, to $.01 in March, 1920, set in motion forces which of themselves tended to improve the rate. The fall of the mark proceeded at a much more rapid pace than the rise of German home prices. Due to this great undervaluation of the mark abroad, foreigners placed huge orders in Germany. Exports increased. Goods of every kind were dispatched abroad post haste. The great "clearance sale," "Deutschlands Ausverkauf," stripped Germany of manufactured goods, of raw materials, even of foodstuffs.[152]

Die unterzeichneten Ausschüsse haben davon Kenntnis genommen, dass die deutschen Werften zurzeit mit etwa 6,000 t Walzmaterial monatlich

[148] Statistisches Jahrbuch für das Deutsche Reich, Sec. ix (Preise).
This gives record of prices for ten years of a number of commodities.
Calwer compiled "a standard food budget" for a family of four.

[149] G. Vissering: International Economic and Financial Problems (Holland, 1920), p. 17.

[150] New York Times, November 8, 1919.

[151] Wolf, *op. cit.*, p. 39.

[152] Frankfurter Zeitung, May 22, 1920.

beliefert werden, während erstaunlicherweise der Eisenwirtschaftsbund die Genehmigung erhalten hat, in den Monaten Mai, Juni je 18,500 t Schiffsbaumaterial ins Ausland auszuführen. Wir protestieren auf das nachdrücklichste gegen diese volkswirtschaftlich völlig verfehlte Massnahme, die nichts anderes bedeutet, als eine ungewöhnliche und dauernde Schädigung der gesamten Wirtschaft.[153]

The demand of these foreign importers for remittances to Germany was, in part, the cause of the rise in Berlin Exchange from $.01 in March to $.029 in May, 1920. On the other hand, offerings of mark bills became scarce. The government closed the "breach in the West."[154] Illegal imports, valued at billions before, now practically ceased. The supply of marks from this source disappeared.[155]

Meanwhile, by a system of export duties established in part to avoid the selling of German goods abroad at "dumping" prices, the government accumulated a large amount of foreign bills.[156] At the same time, the invisible imports due to the "Steuerflucht" and the sales of marks by foreigners greatly diminished: "als der grössere und grösste Teil des auf diesem Wege hinterziehbaren Kapitals hinterzogen war, so dass sich weitere Steuerflucht erübrigte oder sie doch nur mehr tropfenweise vor sich ging, wo es früher ein Platzregen gewesen war, hob sich die Valuta."[157]

To heighten the force of these invisible exports, "bull" speculators lent their activities without fear and without restraint.[158] It seemed unbelievable that the depreciation of the currency of a first-class power from $.238 to barely $.01 in less than six years should be permanent. With the "will to work" of the German people as their basis, marks, it appeared, must rise. From the bank president to the office boy, from the German-American to the Boche-hating Frenchman—all bought marks.

Was die Spekulation in Mark betrifft, so nahmen an ihr seit dem Kriege, übrigens auch schon in ihm, viele Millionen, zumal auch kleiner Spieler, Teil — vom Kellner und Liftboy an — und zwar in aller Welt, wie in Deutschland, so in der Schweiz, in Holland, Spanien, Skandinavien, auch Nord- und Südamerika.[159]

Little did these optimists reckon that their very activity would be the cause of their undoing. At $.029 per mark, German currency was no longer undervalued abroad; on the contrary, as prices in Germany

[153] Wolf, *op. cit.*, p. 42.

[154] Deutsche Allgemeine Zeitung, March 26, 1920.

[155] Frankfurter Zeitung, May 22, 1920.

[156] Deutsche Allgemeine Zeitung, April 22, 1920, gives a complete list of export duties revised to May 1, 1920.

[157] Wolf, *op. cit.*, p. 41.

[158] Economic Review, Vol. ii, p. 483.

[159] Wolf, *op. cit.*, p. 40.

rose 50% in the first half of 1920,[160] and as the mark improved almost 300% between March and May, the spread between German prices and foreign values disappeared. It was no longer advantageous to buy in Germany. To add to this deterrent on exports, the German government had, meantime, instituted a complete and carefully-worked-out system of export duties. Originally designed to equalize German and world prices, this complicated apparatus was not ready to go into effect until the rise of the German index number, coupled with the appreciation of the mark, had already bridged the gap between German prices and world values.

The continuous improvement in the exchange rate of the mark, makes German sales abroad more difficult. It should be added that prices in Germany, for numerous articles, have gradually risen until they now exceed those prevailing in foreign markets. The consequence is that German industries are to a certain extent handicapped in competing in those markets. At this moment, the imposition of new export duties occasions fresh difficulties. The industries are, accordingly, protesting against the duties, the manufactured articles industry, in particular, feeling that it is placed at a disadvantage, since, in many cases, it is harder hit by the new tariff than those industries producing raw materials. The result is that the export of raw materials is facilitated, the very thing the new duties ought to have prevented, for if German industries are again to prosper, they must have sufficient raw materials at their disposal.[161]

To such an extent did the great "auction sale" denude Germany of goods that she had no raw materials left wherewith she could manufacture commodities to send abroad. At the same time, therefore, that her exports ceased she had to import heavily. For the year[162] 1920, Germany had a total debit account on merchandise transactions of 30,000,000,000 marks. Unfortunately this figure does not represent the buying of essentials and raw materials only. It includes also sums for luxuries and illegal imports. For during the latter half of 1920 the "Gap in the West" was wider than ever.[163]

Even if Germany had been able to balance her exports and imports, the mark would, nevertheless, have depreciated as a result of the currency situation. Against a circulation of 35,698,000,000 marks at the end of 1919, total bank notes by December 31, 1920, had almost doubled; bills discounted increased from 27,416,000,000 marks to 60,634,000,000 marks; and Paper Money[164] rose from 11,027,000,000 marks to 23,417,000,000 marks. The effect of this expansion of credit on the value of the paper mark was inevitable: whereas, be-

[160] Frankfurter Zeitung, Index of Wholesale Prices.
[161] Deutsche Allgemeine Zeitung, May 19, 1920.
[162] Complete monthly figures are not available.
[163] Economic Review, Vol. iv, p. 67.
[164] Reichskassenscheine and Darlehenskassenscheine combined.

tween 1914 and 1919, prices had risen only 400-500%, the index number of wholesale prices in September, 1920, was 1560.[165]

Recognizing the influence of this internal depreciation of the mark on the price of Berlin bills in foreign countries, financial centers throughout the world sold German exchange. "The growing flood of paper money in Germany is followed with great attention in foreign countries. Each fresh report of the Reichsbank gives rise to wild speculations,—for the most part, of course, à la baisse."[166]

Even more than the currency position, the uncertainty in the political situation influences the fluctuations of the Berlin rate. Especially vulnerable is the mark to the ever-changing reparations decisions. "The announcement of the postponement or abandonment of the Geneva Conference enabled it to be clearly seen where the causes of the present depreciation are to be sought for. That international speculators would make use of this postponement was foreseen."[167]

At the price of $.011, which the mark touched in November, 1920, German Exchange, despite the adverse balance of trade, the difficult monetary situation, and the ever-changing political outlook, seemed too low. Speculators reversed their positions.[168] That the rally from $.011 in November, 1920, to $0.178 in May, 1921, was not due to underlying economic conditions is evident from an analysis of the commercial, financial and politico-economic developments.

Trade figures based on returns for May through December indicate an excess of imports for the year 1921 of approximately 15-18,-000,000,000 marks.[169] Bad as this indebtedness on current account is, in and of itself, it becomes ruinous when added to the adverse balances of 1914-1920 and to the fabulous holdings of marks abroad. "Die fortwährenden Zuckungen des deutschen Devisenmarktes haben mindestens bis zum Beginn der Reparationszahlungen, mehr mit dem stossweisen Abfluss und Zufluss dieser ausländischen Guthaben, als mit dem Stande der sonstigen Zahlungsverpflichtungen zusammengehangen."[170]

In evaluating the relative importance of commercial and monetary factors in the depreciation of the mark, it is hard to determine whether the adverse trade condition or the chaotic state of the finances have most weight. Whereas the internal depreciation of the mark at the end of 1920 was only 1,500%, within the brief space of twelve months

[165] Federal Reserve Bulletin, October, 1921, p. 1225.

[166] Deutsche Allgemeine Zeitung, January 4, 1921.

[167] Basler Nachrichten, September 17, translated in Economic Review, Vol. ii, p. 469.

[168] Economic Review, Vol. ii, p. 182 and 284.

[169] Monthly trade statistics, January-April, 1921, not published. May-December show an excess of imports of 13,000,000,000 marks.

[170] Dr. Alfred Landsburgh, Die Bank, July, 1921.

the index number had risen to over 4,000%.[171] Astounding as are these leaps and bounds in prices, they are easily explained by the Reichsbank Returns. Compared with December, 1920, the Statement for December 31, 1921, showed that:

(1) Gold reserve fell 97,000,000 marks.
(2) Paper money decreased[172] 16,454,000,000 marks.
(3) Commercial Bills, Cheques, Treasury Bills increased 92,-658,000,000 marks.
(4) Bank Notes in circulation rose 44,833,000,000 marks.
(5) Deposits were higher by 10,578,000,000 marks.

No country can use its printing press in such a reckless way without seriously depreciating her currency.

During the progress of the war Germany's Finance Minister, in defending printing-press methods of financing the war, declared that the mark must be squeezed until it shrieked. By 1918 it shrieked loudly, note circulation having expanded from 2,000 million to 16,000 million marks. Since the armistice, however, circulation has risen to a present total of 82,000 million marks. The effect of this huge expansion of paper currency on exchange was obscured during the war because Germany had practically no imports to pay for, but the day of reckoning was inevitable, and the only question now is whether German financiers can keep the situation in hand.[173]

The overshadowing influence during 1921 was not the adverse trade balance, not the growing unsecured indebtedness, nor even the fantastic increase in note circulation, but the reparations question. The problem of the German indemnity eclipsed all other forces. The constant changes concerning the ultimate settlement, the necessity for finding means of payment, and the inevitable speculation engendered by both these factors, were the determining forces in the hectic downward course of German exchange. Uncertainty, ever-recurring, and ever-increasing is the *leitmotiv* of the reparations controversy. The cumulative effect of the Sanctions, the Ultimatum, the "final" settlement, Germany's plea for time, the finding of the Reparations Commission that Germany must pay, the conditions of the moratorium, inevitably forced marks to lower and lower levels.[174]

In the midst of all these constantly changing rulings, the Reichsbank had to find 1,000,000,000 gold marks in foreign currencies as a first payment by August 31; and before April 30, 1922, it had to pay another 1,120,000,000 gold marks.[175] Exchange traders, knowing that

[171] Frankfurter Zeitung Index Number.

[172] For the explanation of this decrease, *Vide infra*, p. 130.

[173] A. W. Kiddy, New York Evening Post, October 1, 1921.

[174] For a more detailed account, *vide infra*, p. 131.

[175] Summary of the status of reparations payments, United States Department of Commerce, Wall Street Journal, November 25, 1921.

Germany can meet these requirements only by converting paper marks into foreign money, take advantage of the Reichsbank's difficulties by selling marks short.

Erstens handelt es sich darum, dass es nicht nur eine Kursfrage ist, sondern dass das Reich unbedingt Devisen für Zahlungen an das Ausland haben muss, dass die Erlangung von Devisen also nicht gleichbedeutend ist mit dem Rückströmen von Markbeträgen aus dem Auslande. Zweitens aber ist die Markgestaltung stark beeinflusst von einer grossen und verantwortungslosen Devisenspekulation.[176]

In the face of the dislocation in current trade and the overhanging foreign balances, of the expansion in credit and notes, and the ever-changing reparations question, the wonder is not that the mark should have depreciated to a third of a cent, but that it should have retained any value at all on the international exchange market.

While the major swings of the mark are determined mainly by the internal depreciation of the currency, the trade balance and the uncertainties of the indemnity problem, the narrower though more sudden and more irregular fluctuations reflect the infinitely varied factors which the speculative community "discounted." In the hope that the reparations problem would be definitely settled at Paris, traders bid up marks from \$.0133 on January 1 to \$.0182 to January 26. When, however, the London conference achieved nothing marks slipped back during February, and when the Allies imposed the Sanctions the Berlin rate dropped to \$.014 on April 21. The tremendous floating supply of marks held abroad magnifies all these movements; ". . . on the slightest suggestion of further political complications speculators grow nervous and immediately begin to unload."[177] When, on the other hand, the reparations problem appeared to be definitely settled, marks recovered to \$.018 on May 11. The improvement was of short duration. Germany had to find foreign currencies to meet her first payment by August 31; after that date she sold marks to replenish her portfolio of foreign bills. Afraid of continuing depreciation of their money Germans converted marks into foreign currencies. With but slight and unimportant interruptions Berlin exchange declined to \$.0131 by the end of June, to \$.0123 by the end of July, and to \$.0116 by the first of September. Despite the enormous absorption of German currency abroad the decline continued throughout September; marks reached \$.0080 on September 30. On the announcement of the decision concerning the division of Upper Silesia, marks dropped 40% in two days. Buying orders in America and elsewhere caused a rapid though short-lived recovery. By November 8, huge selling in Germany and abroad and the rumors of a visit of the Reparations Com-

[176] Frankfurter Zeitung Handelsblatt, September 28, 1921.
[177] Barclay's Bank, May, 1921.

mission to Berlin resulted in a quotation of \$.0032. Within twenty-four hours the rate rose 25% only to be followed by renewed depreciation. By December 21, in consequence of oversold mark positions and rumors of a moratorium, marks recovered to \$.0060.

From the analysis of the course of the foreign exchanges between March, 1919, and January, 1922, it is clear that the underlying causes which determine the fluctuations are both of a commercial and financial nature. Though the several rates are in general affected by similar forces, conditions in the individual countries differ to such a degree that it was essential to consider the course of each rate of exchange with reference to the influences operating in the particular country.

In the period immediately following the unpegging of the London rate, sterling responded to those influences which remained as a legacy of war conditions as well as to the current commercial and financial forces. As a result of the war Great Britain had accumulated an unprecedented adverse trade balance; during the war she had also financed, to a large extent, the imports of her allies. A large part of the obligations arising from exports from the United States were in the form of short-term credits. The attempt of Americans to realize on their advances created a demand for dollars which depressed the London rate. In addition to the carry-over of sterling from the war period the exchange market was compelled to absorb the offering of bills resulting from the need for financing current British trade. While the adverse balance of Great Britain was small in the first peace year the direction of the trade of the United Kingdom is in part responsible for the depreciation of the pound in New York. England draws the major portion of her imports from the United States; but she sends the bulk of her exports to the continent. Whereas, therefore she must pay in dollars, she receives only pounds or European currencies.

As an outcome of the war sterling exchange not only responded to the adverse trade balance but it also reflected the readjustment in prices consequent on the internal depreciation of the paper pound. The decline in the domestic value of British currency was the result of the inflation of prices in Great Britain, and this in turn was caused by the increasing output of currency notes and the expansion of bank credit, both on government and on private account. To the extent that the paper pound is based not on gold but on irredeemable government securities and that bank loans represent not the demands of trade but originate in government borrowing to that extent the paper pound was at a discount compared to the normal pre-war price of gold. In this first period after the removal of the artificial regulations the decline in sterling exchange was, in some measure, due to short-selling. Speculators "discounted" both the unlikelihood of Great Britain's immediately balancing her exports and imports and the impossibility of an early return to the gold standard. They thus hastened the effect of influences which otherwise would have acted more slowly.

In the first half of 1920 the pound rallied, largely as a result of seasonal influences. But the better trade balance and the courageous action of the Bank of England in raising its discount rate were not without influence.

While in the period of the second major swing, between June 22, 1920, and May 17, 1921, the fluctuations of the pound were less severe, the factors influencing the rate were of a character similar to those operating during the first period. Besides the offering of commercial bills to meet autumn exports from the United States, the market for sterling had to absorb the supply of pounds caused by the repayment of England's share of the Anglo-French Loan. Meanwhile, despite the raising of the Bank Rate, inflation continued. The business community had borrowed from their banks on the basis of high-priced goods. The weaker banking situation compelled another readjustment of prices, and a consequent change in the quotation of pounds.

By the end of 1920 and the beginning of 1921 the banking situation ceased to be a source of anxiety. Trade was no longer one-sided. Great Britain was making progress in equalizing exports and imports. At the same time, however, that England was re-establishing her international balance, her trade fell off enormously, especially with the European States. Consequently, when the settlement of the reparations seemed to give hope of a revival on the Continent the pound rallied. As a result of the coal strike and the payment of the first instalment of the indemnity sterling suffered a temporary setback during the summer of 1921. Since then the London rate has advanced steadily in consequence of a remarkable scarcity of commercial bills, the shipment of gold and the greatly improved banking position.

When, on March 18, 1919, Great Britain unpegged the Paris rate, the franc reflected all the adverse commercial and financial forces. As a result of the war France had a very large unfavorable trade balance, which she had financed for the most part by means of short-term obligations. Instead of reversing this tendency after the close of the war she added a substantial amount to the claims already outstanding against her during the first peace year. The floating supply of exchange originating from the excess of imports of the war period, together with the offering of bills representing current trade, exerted a constant pressure on the franc. Whereas before 1914 France was able to meet her adverse merchandise balance by invisible items, after 1919 she not only received no return on her investments abroad but the claims of foreign countries against her constituted a large invisible import item.

Acting alone the force of the obligations arising from her foreign indebtedness would not have caused the franc to fall to as low a figure as six cents. But France incurred debts abroad at the same time that she inflated her currency. Since the government relied on the manufacture of credit to finance the war, France weakened her banking position and depreciated her currency. Even after the Armistice the Bank of France did not cease to grant accommodation to the treasury; on the contrary, the inflation increased at a more rapid rate during 1919 than during the war years. Realizing that France was very far from the possibility of specie redemption and that her adverse trade balance would continue for some time, speculators, by selling francs short, hastened and at times magnified the movements of the Paris rate.

By April 27, 1920, the depreciation of French exchange was so great that all those who needed to buy Francs tried to fill their commitments at once. At the same time the excellent grain crop permitted France to reduce her imports of cereals, while the decline in world prices reduced the sums of foreign currencies which importers had to buy. These favorable influences on French exchange were intensified by a great increase in exports, both in merchandise and in invisible items. Sales of goods abroad trebled and the presence of foreign tourists created a demand for francs which neutralized to a great extent France's adverse international balance. Meanwhile the action of the Bank of France in making an agreement with the minister of the Treasury to reduce the Bank's advances to the State proved that the Board of Directors were making an earnest effort to check inflation. Forces of a politico-economic nature contributed during this period to strengthen the French rate: the Hythe conference gave hope of a favorable solution of the reparations controversy.

Unfortunately the meeting at Hythe achieved nothing in the way of a definite settlement of the indemnity problem. When it adjourned without results those who had bought francs to "discount" the possible favorable influence of a definite agreement disposed of their holdings. In addition, foreigners who held short-term bills on France took advantage of the high price of French exchange to convert francs into their own home currency, and French merchants who had delayed making payments abroad because of the unfavorable rates on foreign centers hastened to remit to their creditors. At the same time even the excellent grain crops in France could not prevent an unfavorable balance on merchandise account; the excess of imports during 1920, though only half as great as for 1919, still represented a stupendous obligation. In addition to the depreciating influence which these forces together exerted on the franc the Paris rate was further depressed by the repayment on October 15 of part of France's share of the Anglo-French Loan. During this period the exchange market also had to effect a new adjustment of French prices to world values, for despite the promise of the Treasury to reduce State advances, government borrowing steadily increased. Inflation did not cease. The combined force of the adverse commercial and financial factors which influenced exchange quotations during the second period caused a depreciation of over thirty per cent in the franc.

Conversely the favorable trade balance during the first nine months of 1921, the reduction in note circulation by almost half a million francs in the first half of the year and, most important of all, the settlement of the reparations problem in May, strengthened French exchange.

At the beginning of the third major swing in the course of the fluctuations of the franc, the ruling of the Reparations Commission compelling Germany to pay in dollars, weakened the quotations for French exchange. As the Reichsbank sold previously accumulated francs to obtain bills of exchange on the United States the Paris rate declined.

The payments, however, which the Reichsbank made on account of the indemnity met only a very small fraction of the French expenditures "recoverable from Germany." In so far as the reparations remittances did not cover the full amount of reconstruction expenses the government had to borrow to meet the budget deficit. Debarred from resorting to bank advances by its agreement with the Board of Directors the Treasury sold National Defense Bonds. The action of the State in thus borrowing directly from the public neutralizes to a great extent the policy of deflation inaugurated by the Bank of France. The adverse effects of the indemnity payments, of the budget situation and of the ever-present floating indebtedness depressed French exchange.

Realizing its mistake the Reparations Commission permitted Germany to pay in Allied currencies. This ruling, together with the improving trade balance both on account of invisible items and of merchandise exports relieved the Paris rate from immediate pressure. Nevertheless French exchange is still burdened by the large amount of floating indebtedness overhanging the market, by the inflationist practises of the Treasury and by the continuing uncertainties in the reparations problem.

Although Italy continued to control exchange operations in lire after the Federal Reserve Board announced the withdrawal of support in New York, the rate on Milan depreciated to the full extent that the commercial and financial situation of Italy warranted. Like Great Britain and France, Italy accumulated an enormous adverse trade balance during the war period. In addition, the first peace year contributed an excess of imports larger even than the average war year. Since Italy was able to cover only half of this debit account by invisible items or funded credits she was compelled to finance the remainder by arranging short-term loans or by offering her own money on the exchange market. The sale of lire, either in the form of bills or of currency, constituted a floating supply of exchange, which caused depreciation of the rate on Milan. An element of even greater influence in the irregular downward trend of lire during this period is the monetary situation in Italy. Since the government relied to a great extent on the manufacture of credit to carry on the war, the banking position of Italy at the time of the signing of the Armistice was greatly weakened. The fiscal needs of the treasury in the post-war period of transition aggravated the situation. In 1919 the internal depreciation of the lire amounted to three hundred and fifty per cent. In addition the economic position of Italy was so disturbed that it threatened to delay the recovery of Italian trade for many months. Labor unrest during 1919 was almost as great a factor in the fluctuations of the lire as the direct commercial and financial forces.

Despite these unfavorable influences lire rallied in sympathy with pounds and francs. Between April and June of 1920 Italian exchange recovered almost forty per cent.

That this upward movement was not justified by a bettering of underlying economic conditions in Italy is evident from a consideration of the commercial and monetary factors during 1920. Although the condition of the Italian trade balance showed some improvement in consequence of a decrease in the amount of imports and an increase in invisible exports the total of short-term foreign claims against Italy for 1920 added a substantial amount to the floating indebtedness already outstanding against her. Meanwhile the financial condition of Italy grew steadily worse. The demands of the Treasury, coupled with the needs of the business community weakened the banking position. The expansion in notes and deposits during 1920 caused a depreciation of the internal value of the paper lire of almost one hundred per cent. The combined influence of the adverse trade balance, the pressure of floating obligations held abroad and the continuing inflation of the currency resulted in a decline of over eighty per cent in the rate on Milan.

No sooner had the exchange market absorbed the supply of bills resulting from these unfavorable factors when conditions in Italy began to improve. Although the trade balance on merchandise account still showed a debit balance for the first six months of 1921 the early payments for American cereals, and the decline in world prices of foodstuffs, coal and freight rates relieved the Italian exchange market of a part of the pressure which had forced lire down in 1920. At the same time the Italian Banks of Issue were able definitely to check inflation, and even to effect a slight reduction in note and deposit circulation. During this period lire also profited by the settlement of the reparations controversy; for, though according to the Spa agreement Italy is to receive only ten per cent of the German payments, the acceptance of the ultimatum by Germany in May ended, at least for a while, the uncertainty which had overhung the international exchange market.

Lire, like pounds and francs, suffered from the regulation of the Reparations Commission, which compelled Germany to pay in dollars. Since Italian exchange fell rapidly during June in consequence of this ruling holders of bills on Milan, afraid of wasting assets, hastened to rid themselves of lire. During this third period the exchange market for Italian bills was further disturbed by the political situation in Italy. Together, these adverse influences produced a depreciation of twenty-five per cent in Italian exchange.

In the fall of 1921, the greater equalization of merchandise exports and imports and the better banking situation resulted in rising quotations for lire. The diminishing budget deficits permitted the Treasury to reduce its demands for credit while the sale of Exchequer bills enabled the Finance Minister to dispense with the help of the banks. Whereas this new method of meeting expenditure uncovered by tax-revenue relieved the Banks of Issue from the necessity of increasing circulation, it did not necessarily prevent credit expansion. Unless actually accumulated savings, not the bank borrowings of the purchasers, absorb the floating indebtedness, and unless holders look upon these Exchequer bills as investments and not as notes serving as currency, inflation results. While the trade balance on account of exports and imports of goods was much better than in 1920, invisible export items declined. Due to unemployment and the reductions in wages in the United States, emigrants' remittances fell approximately 50 per cent below the level of the previous year.

At present the quotations for lire are influenced by conflicting forces. The more favorable balance in merchandise exports and imports is partly offset by a reduction in invisible exports; the improved position of the Banks of Issue is to a certain extent vitiated by the direct borrowing of the Treasury from the public on the basis of Exchequer bonds; while the large floating obligations held abroad constitute a constant obstacle to rising quotations.

Whereas the Allied countries were able during the war to stabilize their exchanges at or near par, the exchange regulations proclaimed in Germany were powerless either to prevent the depreciation of the mark or to eliminate its fluctuations. Nevertheless the repeal of the Devisenordnung in September, 1919, had almost as great an influence on the Berlin rate as the release of the peg had on the Allied exchanges. After September, 1919, the continued hectic downward movment of the mark reflected the increasingly adverse commercial and financial forces operating on German exchange. Though the blockade prevented Germany from piling up a large indebtedness due to purchases abroad during the war, the intense deprivations caused by this forced isolation practically compelled the German people to import tremendous quantities of goods as soon as the barriers were removed. Thus, although Germany did not incur short-term obligations abroad during the period of hostilities, she accumulated an enormous sum of floating debts in the first peace year. As an offset to an excess of merchandise imports Germany had substantial export items in pre-war years in the form of her merchant marine, her colonies and her property in foreign countries. By the provisions of the Peace Treaty Germany lost all these sources of income. Not only could she no longer meet part of her purchases abroad by the invisible returns for services and investments but the post-war period developed conditions which produced stupendous liabilities. As mark values declined day by day in consequence of the military collapse and the enormous imports into Germany, foreigners who held marks hastened to convert them into thei home currency. In addition, Germans themselves, fearing the result of the Weimar plan for enormously increased taxation, made all possible efforts to obtain non-German exchange. Besides being compelled to absorb the supply of bills originating in the excess of merchandis imports and the wholesale conversion of mark holdings into foreig currencies, the exchange market had to effect a readjustment in value which would take into account the internal depreciation in Germa currency. As in Italy and France the Treasury in Germany relied o loans from the Central Institution to finance the war. So great wa the expansion in credit and currency resulting from this method o carrying on the war that the internal value of the paper mark had depreciated two hundred and thirty per cent when the Armistice wa signed. Since the only means of financing the transition to a peac basis during 1919 was a continuance of this policy of inflation th paper mark by the end of 1919 had declined to half the value it ha commanded the year before. Of even greater significance for Germany than for the Allied countries is the influence of social and political forces. The uncertainty of reparations, the internal disorder and the ever-present fear of a change in government produced almos "acrobatic" movements in the rates for Berlin remittances.

With such vigor did these forces act on the course of Germa exchange that by March of 1920, marks were enormously undervalued in foreign centers. Since it was now exceedingly advantageou to buy in Germany, importers in the whole world placed orders for exports from Germany in such unprecedented amounts that Germany wa stripped of manufactured goods, of raw materials and even of essential foodstuffs. Meanwhile offerings of mark bills due to merchandis imports into Germany became scarce. At the same time invisible item due to the "Steuerflucht" and sales of marks by foreigners had greatl diminished because of the low price of the mark. Attracted by th opportunity for profit which this low rate seemed to offer, speculator bought marks in large quantities. Together, these factors effected an appreciation in Berlin exchange which amounted to almost three hundred per cent in May, 1920.

In consequence of this great rise in quotations marks were no longer undervalued abroad. On the contrary, when the export dutie levied by the German government were added to German prices, values in Germany were actually higher than in foreign countries. The inducement to export had disappeared. Since the great "auction sale" had denuded Germany of goods of every kind she was forced to import heavily to replenish her stocks of raw materials. Thus while exports declined as much as eighty per cent in some branches, imports, even of luxuries, rose enormously. The consequence was a large debit account in merchandise transactions. During this second period in the course of Berlin exchange the banking position deteriorated continuously. The great expansion in note and deposit circulation in 1920 resulted in an internal depreciation of the paper mark of over fifteen hundred per cent by the end of 1920. Not only did the increase in inflation and the floating indebtedness due to the excess of imports affect the course of mark quotations, but the political situation in connection with the indemnity question also had a powerful influence on Berlin exchange. Whereas the postponement of the Geneva Conference caused a sharp fall in the price of bills on Germany, the settlement in May produced a rally of eighty per cent.

That this upward movement was not warranted in view of the underlying conditions is evident from the commercial, financial and politico-economic developments. Though the trade balance for 1921 was better than that for 1920 the excess of imports still gave rise to large foreign obligations. When these are added to the "fabulous" holdings of marks abroad the effect of the total indebtedness becomes all but ruinous. During this period Germany used the printing press to such an extent that the paper mark, which at the beginning of the year was worth one-fifteenth of its pre-war value, had sunk to one-fortieth of a gold mark by the end of the year. More important even than these forces is the reparations question. The uncertain attitude of the Allies in connection with the ultimate settlement, the necessity of finding the means of payment and the inevitable speculation resulting from both these factors were the determining forces in the violent fluctuations and the rapid depreciation of German exchange. While the trade balance may improve, the demands which the indemnity payments make on the German Treasury and the influence which the reparations remittances exert on the exchange market, will prevent any recovery and any stability in the quotations for German exchange.

Although many causes have been set forth to explain the movements of the exchanges, the analysis of the individual rates shows that the elements which compose the trade balance and the factors which bear on the financial situation are the vital forces which determine the fluctuations in the foreign rates. Not only a current excess of imports depresses exchange but the accumulated liabilities arising from former adverse merchandise balances, whether in the form of short-term bills or of currency held abroad are a constant menace to the stability of exchange rates. Also it is not alone the actual unfavorable state of trade which influences the price which a country's money will command abroad; almost of equal importance are those social and political forces which determine the manufacture of goods for export. Labor unrest and grave political disturbances which threaten seriously to impair the productive capacity of a country cause fluctuations in its exchange.

Since the war international settlements originating in capital transactions rather than in transfers of goods have assumed a place of great importance in determining exchange quotations. The reparations problem is an unending source of instability in the course of foreign exchange. Not only do the actual payments produce violent and irregular oscillations; but the uncertainty and indecision in connection with the final settlement cause unending disturbances on the exchange market.

The changing values of the currencies in the European countries necessitate constant readjustments in the rates of their exchanges. Since the weakened financial situation is, in practically all countries, the result of government borrowing, one of the most potent causes of exchange fluctuations is the lack of budgetary equilibrium. In some countries unsound banking on account of expansion in private borrowings heightens the evil effects of government manufacture of credit. At times these factors operate together, at times they act in opposition to each other. But whatever be the direction of these forces they are a constant source of instability for the exchange market.

# CHAPTER III.

## Solutions Proposed.

MANY as have been the causes invented to explain the fluctuations of the foreign rates, they have hardly been as numerous as the solutions proposed and decreed, in all parts of the world, to cure the exchange problem. From the romantic ideal of an international IVA[1] currency to the "peine de mort"[2] ordained by the Pasha of Syria, both experts and laymen have suggested, advocated, preached, even legislated every imaginable remedy.

Reasoning from the successful war experience some have thought of restoring the "peg"; others, realizing that this would involve too great an effort for the Continental countries, would be content with stabilization at current quotations. Some would strike at the source of the supply of bills by regulating the movements of commodities; others would abolish the rates altogether by reinstating the method of exchange of several centuries ago—barter. Dissatisfied with existing standards some would add to each country's depreciated money a sound unit of value convertible at a fixed rate, whereas others would abolish all the currencies of all the countries to substitute an international unit. Some find salvation in credit; others in special and newly-created banking institutions. Some would form a "stable exchange union" as the kernel from which would grow the re-establishment of a universal gold standard; others would prefer to have all currencies anchored to specie simultaneously.

Those who would by all means and irrespective of changing conditions apply past experience to cure present ills advocate the reintroduction of war-time stabilization or "pegging." To peg exchange is to keep the rate at the pre-war parity—as Great Britain did during the war—by making provision for the purchase of such quantities of bills drawn in the foreign currency as might be offered at a rate definitely fixed in relation to the home currency. This creates an unlimited though artificial market for the purchase and sale of exchange at the specified rate.[3]

Such a plan presupposes the maintenance of the pegged rate not only with one country, as in the War, but with all countries; for whereas it was from the United States that the Allies drew by far the greatest part of their imports during the war, since the war they are again carrying on trade with practically all the world. Therefore they

[1] International Financial Conference (Brussels), 1920, Paper No. xii.

[2] A. Raffalovich: Le Marché Financier, Paris, 1919, p. 12.

[3] Willis: *op. cit.*, p. 2.

would have to establish fixed rates of exchange not only with the United States but with all countries. The mere machinery would not be difficult to handle were it not for the expense involved. To keep Allied exchange pegged in New York during the war cost Great Britain annually $1,250,000,000. How, with a deficit of £62,000,000 in England, 25,000,000,000 francs in France, 100,000,000,000 marks in Germany, not to mention other less fortunate countries, the governments of these nations are to find the necessary means for stabilizing their exchange rates, must be a puzzle even to those who advocate this solution.

Even if governments could, by some device, find the funds to peg their exchange, such a scheme would be objectionable because it would mean the re-imposition of war-time restrictions on commerce. Such a hole-proof-system of licensing as would be essential means incalculable loss in delay and friction due to legal formulae.

> The carefully constructed control apparatus is in fair working order—but there is not much left to control. Although complaints are pouring in every day, the government has no intention of abolishing it: abstruse regulations, tedious formalities, impracticable conditions of payment and other regulations which do not pay due consideration to the present situation are paralyzing enterprise and injuring trade. . . . The necessity of abolishing this super-bureaucratic apparatus in toto, or at least remodeling it to meet the needs of the times cannot be doubted.[4]

Not only would pegging be unsuccessful without absolute control of exchange operations; but it would involve fairly drastic restrictions as to movement and production of goods. How a fully worked-out and universally-applied set of rules for trade and tonnage would succeed in peace times, it is of course impossible to tell; certain it is that the partial applications so far adopted with a view toward improving exchanges have not only not been successful but have entailed consequences undreamed of by their advocates.[5]

An evil, greater than the prohibitive expense or the fettering of commerce by re-imposition of war restrictions, is that artificial stabilization above the normal level established by supply and demand of bills aggravates the disease it aims to cure. Where a country's exchange is below parity, either because its currency is at a discount with respect to gold or because of a balance of debt to foreign countries, it is an inducement for its merchants to export: for besides the price of their goods they get the premium on the exchange of the country to which they are sending the goods. Where the exchange is pegged there is no such incentive to export; on the contrary, there is every encouragement to import. Where exchange has a tendency to depreciate it is a sign that a readjustment of price levels is under way. In a country

[4] Frankfurter Zeitung, July 10, 1920.

[5] *Vide infra*, p. 76.

on an inconvertible paper standard the discount on exchanges is a reflection of the currency depreciation: as prices rise exchanges fall to re-establish the relation of prices in the home country with those in foreign countries. Where the rates are artificially held at parity this adjustment is arrested. Rising prices, not offset by falling exchange, attract goods from foreign countries.

To hold the exchanges artificially out of adjustment with relative price levels would be to offer an immense premium on purchases made by private Englishmen in America. . . . An enormous excess of imports would be deliberately stimulated. We should be bringing ease for British purchasers of foreign goods, for the moment, at the cost of our export trade, and of burdening the future with an indefinitely increased foreign debt.[6]

Instead of pegging the rate at the pre-war parity, some have suggested plans for stabilizing exchange at a level corresponding more closely with current quotations. Recognize present devaluation and maintain the pound at $3.65, the franc $.08, the mark at $.02 and the lira at $.05, was Gustav Cassel's suggestion.[7] The most prominent proposals of the type have been advanced by the Frankfurter Zeitung and by Dr. Alfred Landsburgh. The Frankfurter Zeitung would establish a consortium backed by American capital, which would publish rates at which it would buy and sell exchange on New York. It would, of course, be impossible to avoid all fluctuations but "es würde den Bewegungen der Valuta etwas von ihrer Wildheit nehmen können und schon das Bestehen einer derartigen Einrichtung würde den Anreiz zur allgemeinen Valutaspekulation vielleicht stark vermindern können."

Dr. Landsburgh[8] would precede such exchange regulation by devaluation: "die legislatorische Anerkennung des depreziierten Geldwertes, welche Entwertung sich bereits vor langem vollzogen hat und an welche sich die Massverhältnisse des Landes mehr oder weniger schon anpassten."

At this level he would establish a new and permanent par between foreign rates.

When it is proposed to maintain exchange continuously at the stabilized price, the scheme does not differ from that of actual pegging and is earmarked by similar evils. These drawbacks might be overcome by periodically setting the rate up or down as conditions warranted. Besides finding favor in private circles this scheme has appealed to the Committee on Banking and Currency of the House of Representatives. Imbued with the idea that government regulation is

[6] A. C. Pigou, Memorandum 4, Paper xiii, p. 14; International Financial Conference, Brussels, 1920.

[7] Gustav Cassel: International Financial Conference Brussels, 1920.

[8] E. Hantos: Finanz- und Volkswirtschaftliche Zeitfragen, vol. lxxiv, p. 58.

all-knowing and all-powerful, this Committee has introduced a bill to stabilize exchange. By this plan the pound, for instance, is to remain unchanged for a period of three months, say from February through April. On May first it is to be set down or up to where the average would be for the next three months, i.e., from $4.76 to $4.56 for 1919; on August 1, 1919, from $4.56 to $4.21. By this device traders who are worried about a five or six cent fluctuation may console themselves with a periodic jump of thirty or thirty-five cents. It is like advising a man who has difficulty in going up and down steps to take the staircase by fives.

No less potent than the argument from theory is the argument from past practice. Since Cassel advocated a rate of $3.65 per pound, sterling, by a simple response to better economic conditions, has advanced eighty cents; whereas since the Frankfurter Zeitung advised maintaing the mark at two cents, the Berlin rate has fallen to one-sixth of that value. Countries which have enacted the strictest regulations have not only suffered equally with others from "acrobatic" exchanges; they have, in addition, brought upon themselves unexpected and harmful results.

As in many other countries so too in Finland there is a widespread belief in the omnipotence of the state. Import is subject to severe restrictions which call forth bitter complaint from the business world. . . . On the other hand the maintenance of the exchange rate and its improvement which were aimed at could not be achieved. . . . The same object was sought by a severe foreign bills ordinance which has its counterpart in no other country. By its provisions foreign creditors are unable to touch their balances in Finnish banks. The idea was to detain in this way 500,000,000 marks and to prevent their prejudicing the rate. This object has not been attained and the ordinance has caused much estrangement in foreign countries and has frightened away much business from Finland.[9] . . .

The effect on the exchange has been nil:

Selling rate of Swedish Kr. 100 in Finnish MK.

| | | | | | |
|---|---|---|---|---|---|
| Par | 30.1 | 28.2 | 30.4 | 30.6 | 19.8 |
| 138.39 | 483 | 418 | 406 | 500 | 679.60 |

Similarly regulation of Italian exchange dealings and the strict control in Austria, though probably effective in preventing the migration of capital, did not keep up Italian[10] and Vienna[11] rates.

A solution which aims at regulating the supply of bills rather than their disposition after they have already been created is the plan for limiting the movement of commodities. Either through embargoes

[9] Frankfurter Zeitung, August 31, 1920.
[10] Basler Nachrichten, September 30, 1920.
[11] Neue Freie Presse, August 31, 1920.

on exportation or importation, or through the withdrawal of tonnage and other means of transportation, this scheme proposes to limit the volume of bills and hence artificially to control the elements which go into the making of exchange relationships. During the war the absolute control of direction and amount of trade combined with a strict system of licensing exchange transactions served to peg the rates. Whether mere control of imports and exports would succeed in stabilizing quotations is an open question; if past experience counts for aught the plan will not be very effective in remedying exchange fluctuations.

The strict control of trade and transit in Czecho-Slovakia by which practically every tangible and intangible form of wealth was brought under the license system[12] was unable to prevent either the fluctuations of the krone or its depreciation from two and one-half cents in June to one cent in September, 1920. The provisions in Denmark for the rationing of bread and wheat, for the restrictions on imports of articles de luxe and for higher customs duties which, according to the commission, would stabilize exchange, had no perceptible effect on Copenhagen rates.

The elaborate apparatus[13] of export and import restrictions set up in Germany not only failed to stabilize the rate but broke down in consequence of the erratic upswing of the mark from $.01 in March to $0.298 in May. With rising prices in Germany and rising exchange the mark, instead of being undervalued, became overvalued; Germany instead of being a good country to buy in became a good market in which to sell; and since the highest export duties were placed on manufactured articles these tended to remain in Germany and the raw materials were exported. Whereas the ordinance had been passed to increase exports and to reap the spread between the undervalued home prices and world market values, the result was that raw materials, the very basis of exports, were being sent out of the country and total foreign orders for finished goods between January and March fell by eighty to ninety per cent.[14]

Not only may strict regulation of trade be ineffective in stabilizing exchanges but it may lead to results undreamed of by its advocates.

At first sight this simple policy of prohibition may seem very attractive. . . . . But, if French frontiers were open only to raw materials, foreign

[12] Foreign Trade Commission grants export, import and transit licenses for goods of all kinds including raw materials, semi-manufactures and finished goods—excluding government monopolies controlled by the Finance Ministry; export of securites which is controlled by the Finance Ministry; and export of gold, silver, cheques, bills, coupons, money orders, insurance policies, deposit books, letters of credit, foreign currency and Czecho-Slovak notes for which the sanction of the Bank Department of the Finance Ministry is necessary.—Economic Review, Vol. ii, p. 14.

[13] Ordinance Revised May 1, 1920. (Deutsche Allgemeine Zeitung, April 22, 1920.)

[14] Deutsche Allgemeine Zeitung, April 22, 1920.

countries would not fail to close their doors to French goods in return. . . . . The distinction drawn between necessary and superfluous, *i. e.*, "luxury" imports is a dangerous one for France, where the luxury trade is one of the most important economic resources. . . . Excessive taxation or a prohibition of the import of articles de luxe would keep away those foreigners who spend their money in France and whose expenses form a far greater contributing factor to the improvement of the exchange than would the import restrictions.[15]

Even if a plan for limiting the movement of commodities could be worked out which would exactly adjust the debts and claims of a country without entailing unexpected results, it would still not stabilize the exchange, for it would not take into account the financial condition. Though total exports and imports may balance, exchanges are still liable to fluctuations with the monetary situation and the factors bearing thereon. When, for instance, as in Germany, the index number of commodity prices rises to 357 on January 1, 1922, where January 1, 1920, is taken as 100,[16] the mark rate in New York will reflect this currency depreciation; and even the most perfect control to regulate commodities would be powerless to cope with the oscillations in exchange caused by the erratic movements in prices.

Simpler and cruder than this elaborate apparatus of licensing exchange operations, or controlling commodity movements is a return to the system of barter. If the foreign rates are disorganized why try to steady them? Abolish the exchanges. "Schüttet das Kind mit dem Bad aus." By shipping, for instance, raw materials in return for manufactured goods, equivalents are exchanged and there is no need for settling in currency.

If international commerce were carried on in small amounts, by the simple process of exchange of one good in immediate return for an equivalent, barter would never have been abandoned. But the volume of international trade is large, its machinery complex. Many billions of dollars' worth of goods are exchanged every year on the international markets, and instead of the exports of a country paying directly for its imports, its debts may be settled through a third country. Thus if Germany owes Hungary and Austria owes Germany, Austria may pay Hungary to liquidate the debt. Who will decide and in what way can it be determined how much and what kind of glassware, salt or newsprint Austria shall send Hungary to pay for the wheat and maize Germany took from her, where Austria's debt to Germany was contracted on account of shipments of coal, steel and machinery? Add to this complication the fact that Hungary exports her cereals in September, Germany ships her goods in April and Austria pays—in terms of commodities—in December. At what rate of interest shall

[15] Temps, March 30, 1920.

[16] Special correspondence to Journal of Commerce, February, 1922.

the debt for the interval be calculated, and how translate this into terms of porcelain, corn, steel, paper and salt?

The extent to which barter has thus far been used to avoid exchange fluctuations does not justify any sanguine expectations for its future. Of the forty-odd important commercial agreements[17] arranged by the Central European States from November, 1919, to November, 1921, less than one-fourth were for barter exchanges and these only for small amounts.[18]

The main difficulty in the scheme for return to barter is that it tries to cure a disease by abolishing the symptom. Disrupted exchanges result from lack of balance in international indebtedness and from instability in the financial situation. It is not by doing away with the rates, the mere expression of economic conditions, that these underlying evils will be cured.

Others, instead of abolishing exchange rates, would establish new units of currency for each country. They would maintain fixed or theoretic rates for the value of local money and thereby state the basis of converting it into gold. The proposal is in reality a plan for the creation of a gold-exchange standard for all countries on an inconvertible paper basis. Just as the Philippine government redeems the Filipino's pesos in a draft on gold kept in reserve at New York, so, under this plan, the Austrian government, for instance, would give a draft on gold in New York for its citizens' paper crowns. It is essential, if the plan is to succeed in stabilizing rates, that a country on the gold-exchange standard have a fairly equal trade balance with the country where the reserve is located; otherwise, if it should have debts to pay larger in amount than the gold, it would soon be rid of its specie; and if its importers still had foreign drafts to buy they could only obtain them by selling the home currency for what it would bring on the market. This situation could be remedied if the total exports of

[17] Economic Review, November, 1919, to November, 1921.

[18] January, 1920: Czecho-Slovakia sent coal and sugar in return for Austria's shipping newsprint and manufactured goods. (Amounts not made known.)

January 20, 1920: Hungary sent food for Austria's clothes, salt, paper. (Amounts not made known.)

February, 1920: Jugo-Slavia sent food for Austrian shipments of salt.

February, 1920: Austria returned newsprint, agricultural implements, paper goods, glass, clothes, hats, dyes, matches, electric materials, five hundred trucks of salt per month, for the cattle, pigs, hides, skins, 450 trucks of cement, wood and horns which Hungary sent.

April, 1920: Czecho-Slovakia sent textiles and paper. Poland returned petroleum and parafin.

April, 1920: Austria returned manufactured goods for Italy's advancing twenty thousand tons of meal: (in advance of American relief).

May, 1920: Austria bartered manufactured goods for raw materials from Hungary to the value of 300,000,000 kronen.

May, 1920: Denmark and Germany concluded the largest barter arrangement—20-30 million kronen (Danish) per month. Denmark gave cattle, pigs, horses, and Germany returned coal, iron, steel. (Economic Review, November, 1919, to November, 1921.)

the country equalled the sum of its imports. For then it might, by skillfully buying exchanges that are at a discount and selling those that are at a premium, maintain a general parity. When, however, the trade balance with all countries taken together is continuously unfavorable it would ultimately lose its specie. Besides an equilibrium of debts and claims the gold exchange standard pre-supposes a stable currency; for, should there be inflation and should prices rise with exchange maintained at the old rate, imports would be stimulated. If, due to government borrowing or other causes, depreciation of currency should continue, debts would pile up and the reserve would be exhausted. But countries where it is proposed to establish the gold exchange standard have neither an equilibrium in their exports and imports nor a stable currency. So far from balancing her trade, Austria is able to pay for her imports during only three months of the year; and as for her currency, it is but a reflection of the increasing state deficit. Austria's condition is a sample of the position of the other European states the fluctuations of whose rates the gold-exchange standard is to smooth out. Whereas the plan works well for a country dependent on a sovereign state with which it carries on the bulk of its commerce and with which its trade balances, it is ill-adapted for a nation whose markets are scattered the world over, whose imports exceed its exports and which, to crown these difficulties, is inflating its currency.[19] A variation of the gold-exchange standard was submitted by Vissering[20] at the Brussels Financial Conference in the form of a "gold export crown" for Austria. A new bank, free from State influence should be established; its credits to be backed by gold or commercial paper. Whereas all exports and imports are to be reckoned in gold crowns, the Bank would do business with its Austrian clients in paper crowns. The main advantage of the plan was to provide a medium of exchange for the purchase of raw materials. However, it is not the currency in which imports are to be paid for, which is the main source of trouble, but the fluctuations of crowns in terms of foreign money.

Die Auslandsgeschäfte bereiten bei den starkschwankenden Valutapreisen nicht in diesem (Rohmaterial) Punkte Schwierigkeiten, sondern mehr wegen der Gefahren der Kalkulation. . . . Diese Schwierigkeit wird durch die Goldkrone nicht gemindert, sondern erhöht, denn auch sie hat mit der Papierkrone schwankenden Wert. So gibt es für den österreichischen Geschäftsmann zwei Risiken statt eins.[21]

Thus the alternative is either to lose the gold reserve or to submit to two sources of fluctuations—the exchange between the paper crown and the gold crown and between the gold crown and foreign currencies.

[19] Willis: *op. cit.*, p. 4.
[20] International Financial Conference, Brussels, 1920, Paper 12.
[21] E. Hantos: *op. cit.*, p. 60.

A simpler plan than that of creating a new and additional unit of ıl currency for each country, is the suggestion of one universal . international medium of exchange. Though countless variants of ; scheme have cropped up everywhere, they can be classified into ı main divisions according as they would base the money on gold ɔn some other form of tangible or intangible wealth.

Highly fertile in producing such remedies was the International ıancial Conference at Brussels.[22] Though it specialized in ideals for horing currencies to—preferably nothing in particular—it also ught forth definite and detailed plans for basing money on pur-sing power over commodities or on gold. Of the romantic schemes re were many. The Belgian Prime Minister, Monsieur Delacroix, ocated an International Bank to issue interest-bearing bonds in ex-nge for "genuine" securities. "The securities are to consist of hts over customs duties, harvests, mineral products, or any pro-e from which a return can be foreseen in a 'relatively short time,' l which will allow the bonds to be redeemed 'at a not too distant e.'"[23] How, with such a backing for its loans, a bank could long re-in in a liquid position is, at least, a mystery. A Bank of the League Nations, proposed by Carl Thalbitzer, editor of the Finanzstidende, s to "arrange refining and other credits where existing banks cannot er their services." The Bank's principal task should be to maintain : par value of an international unit of account in relation to gold, s unit to be called the "League." Its capital is to be paid either in d or in currencies at the rate of the day.[24] It is an interesting specu-on as to what would happen if, as probably would be the case, all ıntries paid their capital quotas in paper currency and if the Bank uld "arrange such credits as other banks could not offer." When loans, which other financial institutions refused, were seen to lack ırity, liquidity, or both, and when the inconvertible paper paid in capital would depreciate, it might seem to the Directors of the gue Bank that the position of their institution was somewhat pre-ious. Not satisfied with the criticism such proposals have since re-ed at the hands of practical business men in all countries, similar ıs spring up daily. Doctor Aerndt, a prominent German coinage ert, believes an international bank note would not require cover-, "since its character as the legalized medium of payment would ɔlly suffice to give it the necessary value."[25] The utmost practical ıe of this suggestion would seem to be that Doctor Aerndt might oy a very congenial chat with W. J. Bryan, Henry Ford and ɔmas Edison.

More tangible bases for currency and credit issues are goods and

[22] International Financial Conference, Brussels, 1920, Papers 12 and 13.
[23] *Ibid.*, Paper 12, p. 4.
[24] *Ibid.*, p. 33.
[25] Associated Press Dispatch, Journal of Commerce, December 13, 1921.

staples. Plans for tieing money to commodities also abounded in the Conference at Brussels. An I. V. A.[26] system was the solution for exchange fluctuations which the Swiss Free Economy League set forth.

The International Valuta Association—I. V. A.—unit of currency is based on the absolute currency standard; *i. e.*, the equilibrium between the supply of money and the supply of goods resulting from an active currency policy. The basis of this policy is the quantity theory of money: counteract a rise in prices by contracting the amount of media of exchange and vice versa. A country losing its allotment of I. V. A. notes by an adverse balance of trade pays interest on the sum of its former allotment.[26]

No different in principle though worked out in more detail and with deeper thought is Gustav Cassel's suggestion of a "purchasing power parities plan." His fundamental idea is that exchanges depreciate not because of an adverse trade balance, but because of a lessening of the purchasing power of a unit of home money over goods.

Since, according to Cassel, it is the quantity of money that determines its value, the abolition of fluctuations in exchange results not from a restoration of equilibrium between exports and imports but from stability in the currency.[27] The exchange problem thus becomes an international price problem.[28] Let each country decide at what point it wants to fix its prices and if all countries maintain these respective levels, exchanges will be stable.[29] Though this plan does not call for a universal monetary unit it does involve international action: it implies an agreement on the part of all countries to maintain their prices, by expansion or contraction of currency, at the same respective levels. Though well conceived, the solution is uncertain in some respects, in others, incomplete. It is doubtful whether the regulation of the supply of money has that power of adjustment over its value which Cassel attributes to it; the tabular method "bases a standard of value on the price of a number of commodities, the prices of which are to be determined by the very standard which they are to determine."[30]

Even if the quantity theory worked out in practice the purchasing

[26] International Financial Conference, Brussels, 1920, Paper 12, p. 25.

[27] *Ibid.*, Paper 13, p. 21.

[28] To stabilize prices in countries which are still inflating their currencies, it is essential to raise the rate of interest to correspond to the real scarcity of savings; to limit loans to productive enterprises; and to stop government borrowing. In countries which are deflating their currencies it is essential to stop deflation, and to stabilize the price level.
International Financial Conference, Brussels, 1920, Paper 13, No. 4.
Gustav Cassel: Die Geldprobleme der Welt, 1921.
*Cf.* I. Fisher, New York Tribune, December 11, 1921.

[29] Cassel concedes that the large floating balances would have to be funded and that countries must be prevented from selling their currencies abroad for what they will fetch in the market.

[30] *Albert and* Percy Wallis: Economist (London), September 17, 1921.

ɔwer parities plan would be of little assistance in solving the ex-
ıange problem of the countries worst afflicted; for the power to con-
act note and credit issues involves a strong and solvent government—
luxury far beyond the means of most European states. Cassel's
heme, were it possible to apply it throughout, would still leave room
ır wide oscillations; for it would not be possible to counteract a
emium on exchange by an issue of currency fast enough to offset
e scarcity in the supply of bills. No longer hemmed in by the gold
ɪints the fluctuations consequent on trade balances would depend on
e slow-moving effect of price levels[31] on exports and imports.

Others, both in the Financial Conference in 1920 and since, have
oposed international currencies based on gold. Vague and indefinite
eas[32] by French and German writers for an international bank to
ue notes were suggested at Brussels. Professor Schär[33] proposes a
lvent corporation to establish an international currency of account
th a stable relation to gold. Organs of the Bank are to supervise
ports and imports; all payments for goods must be made in the
ernational unit. The Bank would start with a very large capital,
rived from an international loan, and would grant large credits.
nce, for each country the amount would be determined by its export
ıde, there would be a strong incentive to economy. Besides the
estion of practicality this plan involves the difficult problem of ob-
ning credit.[34] A similar scheme, to which the same objections apply,
the proposal of the Swedish Bank Directors, Henrik Axelsohn and
ırl Bittner; they advocate an international Bank—the A. B. C.
ssociated Bankers' Clearing)—with a branch in each country. Upon
25% reserve of gold and commercial paper combined, the A. B. C.
ɔuld lend book credit to every state which deposited in its branch
ɔney or commercial paper, to the value of its import needs for one-
lf year.[35] In the United States ideas for an international bank have
en crystallized into Bills to be brought before the Legislature. Sen-
ɔr Owen would amend the Federal Reserve Act[36] to include a new
ction creating a Federal Reserve Foreign Bank of the United States,
$1,000,000,000 capital, under the supervision of the Federal Reserve
ard and located in New York City. "In a bill to promote interna-
nal commerce, establish credits between countries and stabilize ex-
ınge,"[37] Senator Hitchcock advocates a Bank of Nations. It is to be

[31] *Vide supra*, p. 15.
[32] International Financial Conference, Brussels, 1920, Paper 12, pp. 77 & 82.
[33] Schär: Umgestaltung der Geld- und Währungsverhältnisse.
[34] *Vide infra*, p. 83.
[35] E. Hantos: *op. cit.*, p. 59.
[36] New York Times and Journal of Commerce, January 5, 1922.
[37] Wall Street Journal, November 22, 1921—"A bill to establish a Bank of
ions, to promote and regulate commerce with foreign nations and to act
the fiscal agent for the United States and other governments holding
k." Senate Bill No. 2187, Introduced June 29, 1921.

established in New York City, capitalized at $2,400,000,000, one-tl paid in gold; foreign governments may be admitted by agreement v the President of the United States. Though this bill has attra very little attention it may have been the inspiration of a prop which has received widespread publicity because the author is him a practical banker—F. A. Vanderlip's plan for a "Federal Res system of the United States of Europe." In every way similar to present banking system in the United States, these banks would d their capital—$1,000,000,000—from the United States.

Praised in full and eloquent terms on both sides of the Atla for their "fine idealism" these plans for International Banks and rencies are both unnecessary[38] and impractical.[39] Europe does need banking facilities. Her financial institutions are better ada to her needs than those of the United States. Nor does she d new systems of currency. It is perhaps not unknown that the Fr take a certain pride in their franc crystallized out of the heat of Revolution; it is surely not a state secret that London nurses a ce attachment for the sterling bill of exchange.

Plans that point to partial solutions rather than to complete r dies are the various credit schemes. Without any doubt one of greatest needs of Europe at the present time is capital. The Euro states must fund floating balances abroad, they must have new c

[38] Journal of Commerce: November 17, 1921: "Glittering Ban Schemes."

Journal of Commerce: January 6, 1922: "Banking Nonsense."

New York Times, December 4, 1921: Fantastic Finance.

New York Evening Post, November 19, 1921: It has recently been clusively proved that the United States is unwilling to subscribe even $ 000,000 to a foreign-trade financing undertaking, under the supervision c own banking authorities. It seems unlikely that it would be willing to scribe to an organization whose "corporate existence might be created thr the League of Nations, or in some way that raised it above any parti nationality"

[39] Morning Post, London, November 30, 1921: Establishment under e ing conditions seems to be utterly impracticable whether regarded from financial or political standpoint.

Frankfurter Zeitung, October 28, 1921: "Trotz der also ziemlich la Beschäftigung mit den Fragen eines Wiederaufbaus Europas hat man Durchdenken des Vanderlipschen Planes doch den Eindruck, als ob se Verfasser manche von ihm sicherlich gesehene Klippe als zu leicht ums bar erschiene. Im Ganzen liegt der Plan, wie leider die ganze amerikan Kredithilfe an Europa, noch so im Ungewissen, dass eine Einzelbesprec kaum möglich ist. Das eine lässt sich aus der Geschichte allerdings abl dass bisher wenigstens alle Versuche fehlgeschlagen sind, Staatshoheit Herrschaft über das Geldwesen von einander zu trennen, das heisst also schiedene von einander unabhängige Länder im Geldwesen und nur in di zusammenzuschliessen. Trotzdem ist zu hoffen und wohl auch zu erwa dass der Plan Frank Vanderlips zu weiteren Erörterungen führt, aus d sich etwas Brauch- und Durchführbares herauskristallisiert. Die Zeit ist reif und man wird Vanderlip vor allem das Verdienst zusprechen müssen die brennende Frage nach der Form der Kredithilfe an Europa die erste umrissene Antwort vom Standpunkt eines Amerikaners aus gegebe haben."

begin work. To consolidate into long-term bonds the large sums bills and currencies in foreign countries, presupposes at least the pacity to pay interest on the obligations. Those countries which ve been borrowing on short-term credit abroad or which have sold ɜir money for what it would bring on the exchange market are pre- ely the states whose budgets already show large deficits. There- re, though funding would doubtless relieve the rate from this pres- re, the finances of these heavily indebted nations will not permit such erations at present.

New credit, wherewith to purchase raw materials, would seem be a more immediate need and a more workable suggestion. With s thought in mind, F. A. Vanderlip advocated at the International ıancial Conference at Brussels[40] a large international loan. Secured the combined customs receipts of all benefiting countries and ad- ıistered by an International Loan Commission, the credit was to nish the fundamental means of reconstruction in European coun- :s. There is no question that, with the proper supervision over the of such funds, industry in the central and eastern continental states ld soon show strength and rapid growth. As with all of Vander- s plans it is unfortunately designed for a world more co-operative n ours and imbued with an unquenchable spirit of solidarity.

Noting the drawbacks inherent in an international loan which ows together the resources of the beneficiaries as one lump security, ers have advocated credits to individual countries. But the pre- uisite of a grant of funds, whether to an individual or to a nation, ι strong Balance Sheet and a promising Profit and Loss Account. ıere, however, the only security is the activity of the government nting press and the only hope of liquidity indefinite renewal, there ι be confidence neither in interest payments nor in return of prin- àl. Such is the condition of the states in greatest need of loans.

To provide a means of furnishing raw materials with some assur- :e of ultimate payment, Robert Deumer[41] would organize a mort- ȝe bank in the form of a joint-stock company of 10,000,000 marks ›ital and capable of issuing 200,000,000 marks in debentures. For- ners supplying raw materials would take debenture stock in marks l when German exchange rose would convert it, at a profit, into their ne currency. The plan is an enticing speculation, for should the ue of the mark fall instead, the American exporter would be an oluntary investor in the debenture of a mortgage bank, and although l estate would doubtless rise in value with the fall of mark exchange, American exporter's working capital would be solidly moulded into :ortgage loan.

With a view to making the transaction both safe and liquid. Sir

[40] International Financial Conference, Paper xii, p. 27.
[41] Die Bank, January, 1920.

Drummond Fraser advocates the Ter Meulen Bond Plan. This device is based on the principle that in a country whose traders cannot command the requisite credit from foreign exporters, the government of that country must intervene by pledging the national credit for redemption of the home merchants' obligations. The government makes the pledge in the form of bonds based on specified public revenues under supervision of the Committee of International Bankers. The importer, upon proving his solvency to his government, receives, as a loan, bonds to cover his engagement. These he pledges with the foreign exporter. When he has paid the consignor abroad, he receives back the government bond, which he returns to the issuing agency.

The Ter Meulen plan is practical; though perhaps only on a limited scale, it would help raise the exports of the debtor nations and thus ultimately aid in stabilizing exchange.

Either in conjunction with credit plans or as an independent means of furthering trade and thus solving the exchange problem, the War Finance Corporation, Edge Act Corporations, Overseas Trade Act enterprises and other institutions have been advocated. The War Finance Corporation was formed to meet the need for materials in the countries of Europe. Organized with a capital of $500,000,000, under the Treasury Department, it took the obligations of the American exporter, backed by the paper of the European importer, endorsed by his bank and guaranteed by his government. The Edge Law authorized banking corporations to do a foreign business. Under the control of the Federal Reserve Board and empowered to exercise all the banking functions, Edge Law corporations could also issue bonds and notes to an amount equal to ten times their capital and surplus and could purchase and hold stock in corporations not transacting business in the United States.

British export trade has at its disposition, government aid in the form of cash advances—analogous to the War Finance Corporation—government guarantees of export drafts, and government participation in losses suffered by banks. Of these three forms the draft guarantee is the most important. Guarantees are "general" where they require no reference to the Export Credits Department for each transaction; "specific" where such reference is necessary.[42]

[42] Bills drawn under the "general" form of guarantee should be limited to six months, but may be renewed up to twelve months. The guarantee covers the full amount of the bills and recourse will be had against exporter for 57½% of the ultimate loss. A peculiarity of the guarantee when security is deposited by importer is that the government has to stand back of its appraisal of the security. If the security does not realize the appraised amount the government has to bear the full loss. This applies to both "general" and "specific" guarantees. The "specific" guarantee may be for 100% of total amount of bill of exchange, in case credit does not exceed twelve months, or for an amount not exceeding 85% in case credit exceeds twelve months. Where no security is deposited by importer, Exports Credit Department requires that Importer's bank guarantee that bills will be accepted; and when security is *deposited* importer's bank must guarantee that bills will be accepted and stipu

Similar to the British plan is the Belgian government guarantee 50,000,000 francs for five years. The deposit of state securities ie purchasing country enables the contract for the exchange of tin specified goods, to be fulfilled.[43]

Were there a real dearth of banking facilities of this nature, it ıld doubtless have shown itself in the activities of these various in- ıtions. Their operations, however, have been almost insignificant. : War Finance Corporation, up to May 10, 1920, entered into com- rnents of only $50,000,000;[44] in the second period, since January, :1, when Congress authorized resumption of its activities, it ad- ıced $51,524,000 to finance exports.[45]

Of the £26,000,000 authorized under the British Overseas Trade :t, passed in September, 1919, only £2,000,000 had been utilized to November 1, 1921; since the amendment of the act in October, '21, the plan has been used more freely.[46]

These schemes assume that there is a trade to be done and merely lace on the shoulders of those able to bear it—state or special cor- orations—the abnormal risk involved in trade credits spread over years instead of the normal three to nine months. Unfortunately this assumption is not warranted. In the worst cases the importer has no goods to trade and no prospect of producing any within the terms of the credit; in the better cases he cannot produce the adequate security to cover the risk of a fall in the value of his currency measured in sterling or dollars.

Thus we are brought up against the two fundamental obstacles to a resumption of normal trade relations. Some of the most important areas, Russia and Austria in particular, have nothing to trade with, and need far longer credits than the three years contemplated in these schemes, to give them any chance of producing a surplus for export; while all trade is obstructed by the instability of the exchanges, which makes any commercial transaction that spreads over a period of more than a month a wild speculation.[47]

lated security deposited immediately upon first presentation of documents to importer. When guarantee is for 85% of bills, recourse is had against exporter for 50% loss, and when guarantee is 100% recourse is for 57%. Length of credit which is to range from one to six years, will be determined by the character of the goods. To avoid the cumbrous procedure whereby the Department of Overseas Trade had to sanction each transaction, a special business committee is to fix a maximum for each firm. Area is extended to include not only the British Empire and devastated countries but apparently all other countries. Wall Street Journal, January 26, 1922; Federal Reserve Bulletin, February, 1922.

[43] Bulletin de Documentation Economique, May 5, 1921.

[44] Friedman: *op. cit.*, p. 368.

[45] Report of War Finance Corporation, November 30, 1921.

[46] Wall Street Journal, January 26, 1922.

[47] Henry Clay, New York Evening Post, October 29, 1921.

Less grandiose than the plans for establishing world banking or currency systems, yet requiring a certain degree of international co-operation, is the idea of a "Stable Exchange Union." H. Parker Willis suggests that those countries which have been able to remove the causes of instability which originate in inflation and unbalanced trade combine to re-establish the pre-war machinery of exchange. Such a Union would include the United States, the European neutrals and probably Great Britain. Later, as one continental country after another entered the pale of civilized commerce and finance, it too, would gain admittance to the Union. In order to hasten its eligibility the United States would advance each country as it proved fit an amount of gold sufficient to place its currency on a specie basis. Within the "Stable Exchange Union" that mechanism which pre-war experience had shown to be the effective means of maintaining stability in the exchange market, would again function: the use of the discount rate in conjunction with a flow of gold. The plan thus involves the double idea of convertibility for a limited, though increasing number of countries, and of free movement of gold as between these countries.

The solution is—professedly—incomplete. Since convertibility in itself involves a number of prerequisites[48] it is not likely that any of the former belligerents, with the sole exception of Great Britain, will be able, in the near future, to return to the gold standard, even with a specie loan from the United States. The "Union" would, therefore, consist only of the United States, the neutrals and Great Britain; the plan would leave the exchange problems of almost the entire Continent unsolved.

Even within its narrow sphere it is doubtful whether the suggestion would work out effectively. Since a country's currency is at par only where its debits and credits with all countries taken together are equal, Great Britain, for instance, would have to have an equilibrium in her trade balance with those countries which at that particular time happened to belong to the Exchange Union; otherwise she would lose her gold to her creditors or conversely other countries would have to lose theirs to Great Britain. As a matter of fact, Great Britain is at present a debtor of financially strong countries, a creditor of financially weak ones. While she would be settling her obligations by shipping gold, her debtors would be meeting theirs by borrowing or by converting their currencies into sterling.

A vivid illustration of this situation is the course of gold movements during the past year: almost all the metal mined in South Africa during 1921 came straightway to the United States.[49] The existence of a "Stable Exchange Union" might spur other countries on toward hastening their rehabilitation; yet the solution is rather incomplete; it is doubtful whether it could be made to work effectively.

[48] *Vide infra*, p. 103.

[49] *Annalist*, January 9, 1922.

# CHAPTER IV.

## THE REQUISITES OF STABILIZATION

### Equilibrium of the Budget.

NOT by enforcing fancy schemes devised to escape economic law, nor by adopting plans designed to solve the problem only in part, but rather by righting those conditions which are the causes of disordered quotations will stability return to the exchange market. "It is important to bear in mind that that which is really to be corrected is not the actual position of the exchanges, but that state of things which has brought it about."[1] As truly as the quivering needle of the barometer registers the variations in atmospheric pressure, the fluctuating rate in the foreign bills market points to the changes in the state of world trade and finance. Just as, while a storm is raging, the barometer will not read "fair," just so the exchanges will not be stable while international commerce is disorganized and the monetary situation troubled. To clear the business atmosphere of those disturbing elements which produce fluctuations in the rates of foreign bills, is the essential prerequisite of stabilization. "The exchange problem is not one of currency but of economics . . .; it cannot in any way be solved by currency measures . . .; its solution depends entirely on a combination of economic with financial measures."[2] Some contemporary plans ". . . err in being too paternal or too complicated; also, sometimes in being too pessimistic. The patients need neither drugs nor surgery, but healthy and natural surroundings in which they can exert their own recuperative powers."[3]

Since the historical analysis shows that the forces which sway the exchanges are, directly the monetary and commercial factors, and, indirectly those political and social phenomena which bear on the trade or finances of a country, any plan for solving the exchange problem implies the cessation of inflation, whether on government or on private account, the settling of international indebtedness, both inter-allied and reparations, and a restoration of commerce and trade. The constant movements in the exchanges during the last three years have in large part been the reflection of the attempt on the part of the exchange market to adjust the price levels in the various countries.[4] Both in the course of the war and during the post-Armistice period the several countries inflated their currencies in different degrees. To maintain on

[1] Goschen: *op. cit.*, p. 123.
[2] A. Feiler: Frankfurter Zeitung, June 1, 1920.
[3] J. M. Keynes: A Revision of the Treaty (London, 1922), p. 170.
[4] *Vide supra*, pp. 24, 35, 44, 54.

the one hand the correct relationship between the prices of commodities in the different countries and on the other the equilibrium in the values of the goods as amongst themselves, involved corresponding changes in the quotations of foreign bills. A rise in prices connotes depreciation of the currency; inflation registers itself in the rate of exchange.[5] "It should be plainly recognized that the disturbance to which exchange has been subject during the past year is not exclusively due to balance of trade, but is largely the outcome of depreciation of the currency."[6] As every increase in credit and currency means a rise of prices so every rise of prices means further depreciation of exchange. "The weakness of the exchanges is, in a measure, due to trade conditions, but an important cause of the depreciation of sterling in New York and other financial centres is, in our opinion, to be found in the expanded state of credit in this country."[7]

The most potent cause of inflation in European countries is the borrowing on government account.

A large part of the credit expansion arises as we have shown from the fact that the expenditure of the government during the war has exceeded the amounts which they have been able to raise by taxation or by loans from the actual savings of the people. They have been obliged therefore to obtain money through the creation of credits by the Bank of England and by the Joint Stock Banks with the result that the growth of purchasing power has exceeded that of purchasable goods and services.[8]

Since the manufacture of credit based not on immediately exchangeable commodities, but on the intangible mortgage of the possible future savings of the people results in inflation and consequent depreciation of the exchanges, the starting point of all efforts to restore order and security in the mechanism of international exchange must be the cessation of government borrowing.[9] Fiscal progress everywhere

[5] Seligman: *op. cit.*, p. 59.

[6] Willis: *op. cit.*, p. 4.

[7] Final Report of the Committee on Currency and Foreign Exchange after the War, December, 1919. Over a century ago, The Select Committee on the High Price of Gold Bullion in Great Britain, 1910, p. 34, found a similar explanation for similar conditions: "Your committee finds it difficult to resist an inference that a portion at least of the great fall which exchanges lately suffered must have resulted not from the state of trade but from a change in the relative value of our domestic currency. But when the deduction is joined with that which your committee has stated, respecting the change in the market price of Gold, that inference appears to be demonstrated."

[8] First Interim Report of the Committee on Currency and Exchange after the War, January, 1918.
*Cf.* Gustav Cassel: World's Monetary Problems, Memorandum 3. Paper xiii; International Financial Conference, 1920.

[9] *Cf.* G. W. J. Bruins, Memorandum 2. Paper xiii. International Financial Conference, 1920.

"imperiously demands a re-establishment of budgetary equilibrium."[10] Wherever revenues fail to meet expenditures the central banks of issue must grant credits to the government, which, by paying them out, creates additional buying capacity. "Mit Rücksicht hierauf ist es richtig, wenn man behauptet, dass durch die Geldschöpfung des Staates soviel 'zusätzliche Kaufkraft' geschaffen werde, dass die Preisbildung unbekümmert um die Aufgabe des Geldes gefälscht wird."[11]

To balance their budgets, European states must energetically prune down expenses and graft on to an already complicated tax program additional sources of revenue. Despite the devastating consequences of war-time expenditure on armaments, European nations are still spending an average of 20% of their receipts on armies and navies. Though their subjects be in want of food and their machinery in need of repairs, these states prefer to maintain military equipment out of all proportion to the capacity of their people to support it. It is imperative not for the mere well-being, but for the very life of the European countries that they save the sums now lavished on armaments to avoid future budget deficits.

The statements presented to the conference show that on an average some 20% of the national expenditure is still being devoted to the maintenance of armaments and the preparation for war. The Conference desires to affirm with the utmost emphasis that the world cannot afford this expenditure; only by a frank policy of mutual cooperation can the nations hope to regain their old prosperity; and in order to secure that result, the whole resources of each country must be devoted to strictly productive purposes.[12]

Where the surplus from annual production "is destroyed, or even nibbled into, by the conversion of the productive consumption of a normal economic life into the unproductive consumption of government outlay for military or naval purposes, the results are sooner or later bound to be disastrous. In the long run, political security cannot be purchased at the cost of economic debility."[13] Whereas it lies within

[10] Seligman, *op. cit.*, p. 58.
A. C. Pigou Memorandum on Credit, Curreny and Exchange Fluctuations 4. Paper xiii. International Financial Conference, 1920.
Finanz- und Volkswirtschaftliche Zeitfragen: p. v. 74, p. 27.

[11] *Ibid.*, p. 27.
From the point of view of the theory of prices it is an interesting speculation as to whether an increase in currency causes a rise in prices or whether an initial scracity of goods produces a rise in prices and a consequent demand for currency. From the point of view of the exchanges, the only thing which matters is that, due to the uneven rise in prices in the various countries values were out of joint. (*Cf.* the voluminous literature on this subject in connection with the foreign exchanges by Bendix, Liefmann, Knapp, Wolf, Beckerath and others.)

[12] League of Nations Official Journal, October 1920, p. 425.

[13] Seligman: *op. cit.*, p. 65.

the power of states to cut down expenditure on future military operations, the expenses entailed by past wars are unfortunately almost irreducible. By far the largest single item in the budgets of the recent belligerents is the interest on government obligations. Debt services consume between 30% and 50% of the government income. In view of the heavy burden on the community which these figures connote, any reduction, however small, means substantial relief. Governments should therefore as quickly as possible pay off their short term obligations.

Aussi longtemps que cette inflation fiduciaire formidable n'aura pas disparu; tant que la plus grande partie des avances faites au gouvernement par la Banque de France ne seront pas remboursées et que la dette flottante n'aura pas été consolidée, nous ne pourrons pas retrouver un change normal; dans la situation actuelle, notre monnaie est trop depréciée.[14]

Where it is not possible for governments to reduce the principal of their debts, they should attempt to refund them at lower rates. Just as soon as the investment market permits, governments should substitute for their floating obligations bonds at the lowest possible rates of interest and refund those long-term debts which bear abnormally high charges.

A primary condition of the restoration of a sound credit position is the repayment of a large portion of the enormous amount of government securities now held by the banks. It is essential that as soon as possible the state should not only live within its income but should begin to reduce its indebtedness. We accordingly recommend that at the earliest possible moment an adequate sinking fund should be provided out of revenue, so that there may be a regular annual reduction of capital liabilities, more especially those which constitute the floating debt. We should remark that it is of the utmost importance that such repayment of debt should not be affected by fresh borrowings for capital expenditure. . . . The shortage of capital must be made good by genuine savings. It cannot be met by the creation of fresh purchasing power in the form of bank advances to the government or to manufacturers under government guarantee or otherwise, and any sort of expedients can only aggravate the evil and retard, possibly for generations, the recovery of the country from the losses sustained during the war.[15]

A field which offers almost unlimited possibilities for economy is the very complex and war-swollen item of Civil Service. Partly for humanitarian reasons, but mostly on political grounds, governments have allowed departments created for military purposes to continue their operations long after their period of usefulness had passed. It is essential that states liquidate at the earliest possible date these under-

[14] Temps, June 30, 1920.

[15] *First Interim* Report of the Cunliffe Committee, January 1918.

takings and that they limit their activities to the indispensible government functions. While it was inevitable, during the period of hostilities, for governments to provide goods or services at less than cost price, it is just as essential now to abolish these subsidies. For, whereas in time of war, victory alone matters, in time of peace, stable finance must again take its place as the basis of sound economic conditions. Not only are the subsidies responsible in large measure for the government deficits[16] but by furnishing the people with necessaries at low prices they leave them with more purchasing power for non-essentials.

To cut down expenditure on a large scale is, however, a hopeless task without radical restrictions in the field of expenditure and hence of the functions which the State pretends to fulfil. In the first instance, there is the attempt of government to reduce, at the cost of the exchequer, the price of certain commodities and services beneath cost. Such practices must completely and as soon as possible be abolished. This involves of course an increase of prices for bread or of railway fares or postage, or of whatever may be the prices artificially kept down. But the buying capacity of the consumer is thereby reduced,—the result will be a tendency to depression of other prices. At the same time, the government will be able to reduce their demand for artificially manufactured buying capacity and thus a restriction will be laid upon further inflation. A cessation of all unnecessary direct subsidies to the unemployed or other consumers will cooperate to the same effect.[17]

In every branch of ordinary recurring expenditure the watchword of the government should be "save": "Aeusserste Sparsamkeit auf allen Gebieten ist notwendig. Alle unproduktiven Ausgaben müssen auf ein Mindestmass eingeschränkt werden, die Arbeitslosenunterstützung ist ehestens durch Arbeitslosenversicherung zu ersetzen, die Zuschüsse zur Verbilligung der Lebensmittel müssen aufhören."[18] It is not enough, however, that nations abolish those departments which are no longer necessary for the conduct of government; it is just as important that they reduce, in corresponding measure, the number of government employees. No nation can keep one-eighth or even one-tenth of its population on the payroll for unproductive government services and still hope to maintain itself in a condition of health and vigor.

Das Staatsbudget muss ausgeglichen werden; keinerlei Ausgaben dürfen ohne vorherige Sicherung entsprechender Einnahmen bewilligt werden. Das Reich muss von zahlreichen Ausgaben, die es während des Krieges übernommen hat, entlastet, der Beamtenapparat verringert werden; das kleinere Deutschland kann das ungeheure Beamtenheer nicht bezahlen.

[16] For instance, the cereal subsidy in Italy during 1920 cost 6,000,000,000 lire, the deficit for the same period was 14,000,000,000 lire.

[17] Gustav Cassel: World's Monetary Problems, Memorandum 3. Paper xiii. p. 25.

[18] Max Warburg: Deutsche Wirtschaftszeitung, December 1, 1920.

So urgent is it that expenses be kept within very narrow bounds that even productive extra expenditure should be limited to the most outstanding needs. Though it is of incalculable value for future production that devastated areas everywhere be rebuilt, the shortage of capital and the consequent high rates of interest, coupled with the danger of a debit balance in the budget and consequent evil of inflation must restrict expenditure even for capital purposes to the lowest amount.[19]

Insofar as, after every effort has been made, it is impossible to cut down expenditure within the limits of existing revenues, fresh taxation must be imposed and the process must be ruthlessly continued until the revenue is at least sufficient to meet the full amount of the recurrent ordinary expenditure.[20]

Essential though it be to meet the full sum of government expenses by actual income, there is a very definite limit beyond which the government cannot exact taxation. If it oversteps this limit, it impinges not only on the formation of new wealth but even on the maintenance of existing capital.

A taxation as excessive as that encountered to-day even in the United States, not to speak of the rest of the world, cannot be continued without hazard. No country can long endure the application of so large a part of the social income for purely unproductive consumption without suffering a marked retardation in the tempo of its economic progress. For it is only out of the setting aside of an appreciable surplus of annual production that a nation's capital can be replenished and the economic resources strengthened.[21]

Where the government attempts to take not only the savings representing new accretions to wealth, but even, as in most Continental countries, capital already in existence, taxpayers either resort to their banks or else find means of evasion. When the taxpayer meets his government's demands by borrowing, credit expansion results as inevitably as if the state discounted its own treasury bills with the Central Institution; when the state tries to appropriate to itself amounts so far in excess of the people's capacity that payment would mean real hardship, it will lose more by their attempts to evade the whole amount[22] than it would by levying taxes at a more moderate rate.

Sehr hohe Steuern sind unvermeidlich, aber Ueberspannung der Steuern zerrüttet das Wirtschaftsleben, *untergräbt die Steuermoral and wird stets*

[19] Max Warburg, Deutsche Wirtschaftszeitung, December 1, 1920.
Cf. League of Nations Official Journal, October 1920, p. 426.

[20] *Ibid.*, p. 425.

[21] Seligman: *op. cit.*, p. 65.

[22] *Cf. the "Flight of* Capital" from taxation in Germany.

*die Erwartung enttäuschen.* Neben den hohen Reichseinkommensteuern und den Erbschaftssteuern, die in Zukunft jede übermässige Kapitalbildung verhindern werden, sind weitere Vermögenssteuern nach Durchführung der Kriegsvermögenssteuern und des Reichsnotopfers auf Jahre hinaus nicht mehr denkbar. Der steuerliche Mehrbedarf des Reiches muss durch indirekte Steuern und Steigerung der Einnahmen aus den werbenden Anlagen des Reiches gedeckt werden. Diese sind zu entbureaukratisieren, um sie erträglicher zu gestalten.[23]

## Sound Banking.

In trespassing on the grounds of unsound finance, the government is by no means the sole transgressor. During and even after the war, banks made loans which violated all principles of sound finance. By lending on the basis of government paper they substituted unliquid obligations for the rapidly maturing trade bills of pre-war days; by advancing money which borrowers used not to facilitate the exchange of goods, not even to provide working capital, but to sink in fixed plant or equipment they tied up funds needed for day to day requirements; by permitting customers to borrow at the low rates of interest which governments desired they destroyed that force which in normal times regulates the flow of liquid wealth into productive or consumptive channels.

The question of restoring the banking and currency system to a stable foundation is not merely a question of putting public finance into a solvent condition; it is also a question of adopting a new and sounder banking policy. There was no greater evil in this connection than that of habitually using Government obligations of various kinds either as a backing for currency notes or else as a basis for rediscounting of paper which gave rise to banking deposits.[24]

In normal times all sorts of credit creations, private and government alike, were limited by the drain on bank reserves which they set up to provide currency wherewith to meet the higher prices.[25] During the war the restrictions which caused an increase in the amount of currency to mean a decrease in the sums available for bank reserves were removed. Expansion might thus be unlimited. In order to restore the principles of sound banking which the experience of pre-war years had tested out, it is imperative that banks make loans on the basis not of unliquid government obligations but of constantly maturing commercial bills, not for fixed capital purposes but to facilitate the bona-fide exchange of goods, not at the abnormally low interest charges instituted by needy treasuries but at rates commensurate with the appalling scarcity of real savings.

[23] Max Warburg: Deutsche Wirtschaftszeitung, December, 1920.
[24] Willis: *op. cit.*, p. 6.
[25] A. C. Pigou: International Financial Conference, 1920. Paper xiii.

However small the savings which the tax-exacting activities of European governments leave to their citizens, it is essential that even these be used to pay off bank loans secured by government obligations. Only when these securities have passed from the vaults of the banks into the hands of bona-fide investors do they lose their power of credit expansion. Absorbed by real savings, they can no longer form the basis of note or deposit currency.

Hardly less important is it that business men liquidate bank loans incurred for capital expenditure. During the war, the enormous demand for goods and the rapid rise of prices tempted producers and manufacturers everywhere to add to plant and equipment. Since the governments siphoned off from the investment market all available funds, business men relied on their banks to provide them with means both to carry on their ordinary transactions as well as to enlarge and expand their businesses. In this way banks tied up their fluid funds in obligations which, though short-dated and constantly maturing were, in reality, by virtue of endless renewals, long-term bonds. Unless bankers everywhere wish to pour those funds which should serve in the daily exchange of commodities, into the moulds of fixed plant requirements; unless they wish to confound the genuine functions of commercial banking with the services of the investment market, they must induce their customers to pay off their obligations.

> So long as it is legal for the state to create new currency without limits it is possible for continually growing credits to be created on private behalf even though it is no longer being done on behalf of the government. Measures must be taken to stop the indefinite creation of bank credits on private behalf.[26]

If financial practice in the European countries is again to be founded on the sound principle of issuing note and deposit currency only on the basis of self-liquidating paper, the accumulated surplus in the community must provide the means for capital expenditure. The state can reduce its indebtedness only to the extent that it can raise enough by taxation to cancel its obligations; private individuals can liquidate paper secured by treasury obligations only by laying aside sufficient funds to pay off their loans; banks can place undigested government securities with the public only when the people have surplus over current needs to invest; business men can meet at maturity bank loans obtained for capital purposes only when either they themselves or others in the community have been able to save funds sufficient to take up the floating indebtedness and convert it into long-term bonds.

Before the war the rate of interest regulated the due distribution of labor between the supply of goods for current consumption and

[26] A. C. Pigou: Credit, Currency and Exchange Fluctuations, *memorandum 4. Paper xiii.* International Financial Conference (Brussels, 1920) p. 9.

production for capital purposes.[27] The imperative need for money the part of all governments during the war caused treasury ofıls to place with the public loans at charges commensurate rather h the patriotism of investors than with the real scarcity of capital. ce, after the war, the restrictions on credit expansion which caused increase of notes or deposits to mean a weakening of bank re-/es were still unenforced, it was profitable for banks to treat tomers with magnanimity.

ıays the banks to lend capital *through money* at an abnormally low relatively to that at which it can be obtained in the capital market; it pays business men therefore to finance themselves through the ks by getting them to create credits rather than by getting the public ıntarily and knowingly to save real things.[28]

rimary need for the restoration of a sound credit position is the re-.blishment of equilibrium between the production of consumable ımodities and the supply of capital goods. Since the rate of in-st is the most effective instrument for maintaining this balance, essential that it reflect the scanty supply[29] of real savings.

urther step therefore is required over and above the cessation of :rnment borrowing and the funding and repayment of floating debt; sures must be taken to stop the indefinite creation of bank credits on ate behalf. This may take the form either of the imposition of high c rates or of a legal prohibition of further manufacture of notes. The ıer method leads indirectly to a stoppage of note manufacture; and latter method leads to high bank rates. They are really two paths to ;ame end.[30]

Whether the obstacle in the path of a return to sound banking the form of floating government indebtedness directly discounted the banks or private loans based on state obligations; whether

[27] "In an economic sense an effective Bank Rate may be defined as that ge on the community necessary to regulate the supply of floating com-ities according to the current standard of living. In pre-war times when : was a temporary overproduction, usually evidenced by a trade slump, a ction in Bank Rate, sooner or later, followed, and indirectly eventually :ssed the position by causing a diversion of labor from production of s for current consumption to production of capital goods, i.e. new mills, ısions, plant, etc., and vice versa when Bank Rate was increased." kaldy: *op. cit.*, p. 353.)

[28] Pigou: *op. cit.*, p. 9.

[29] "The necessity of providing for our indispensable supplies of food and materials from abroad and for arrears to repairs of manufacturing plant the transport system at home will limit the savings available for the new al expenditure for a considerable period.

(Interim Report of the Cunliffe Committee, January, 1918.)

[30] Pigou: *op. cit.*, p. 9.

*Cf.* Gustav Cassel: *op. cit.*, p. 22. Also Cunliffe Committee (Interim report), January, 1918; and Willis, *op. cit.*, p. 6.

the hindrance on the road to stable monetary conditions assume the shape of bank investments in short-term certificates of indebtedness or paper representing capital investment, the re-establishment of a stable banking position demands the raising of the interest charge to that rate which will regulate the supply of consumable goods according to the reduced standard of living.

### Settlement of International Debts.

So inextricably is the question of international indebtedness enmeshed in the closely-woven net of commerce and finance that, unless it is to envelop the whole world in a hopeless tangle, it must be unravelled in an orderly fashion. From the analysis of the forces which sway the exchanges, it is clear that the Reparations problem has both a very definite direct bearing on the fluctuations and an indirect influence which is even more potent and more far-reaching. Not only do the current remittances and the uncertainty concerning the manner and amount of future payments cause violent oscillations in the market for foreign bills, but the intimate relation of the indemnity to the various government budgets and its inevitable influence on the distribution and direction of world trade produce effects on the exchanges which, if less spectacular, are more dangerous and more lasting.

That Germany's remittances on Reparations account produce wide fluctuations in the price of bills is unmistakable from the hectic course of the various rates at the time when the Reichsbank pays the successive instalments.[31] Since the German government is compelled to procure 6,000,000,000 gold marks worth of foreign currencies each year, it must, in the absence of a corresponding surplus of export items, convert marks into the required currencies. This periodic supply of marks exerts a pressure on the Berlin rate which is at times all but catastrophic.

More disturbing even than the actual government operations is the element of uncertainty. "In considering our present financial conditions and developments it is important to give adequate recognition to the extraordinary uncertainty concerning political and social developments."[32] Uncertainty as to time and place of payment makes the importer waver as to when to remit; uncertainty causes the merchant to consider and to reconsider where and when to buy or sell; uncertainty leaves the banker undecided when to cover his comitments; uncertainty feeds the flames of speculation. The ever-present possibilities of change in the final total of reparations only serve to magnify these effects. "Our present troubles, when they are not attributable to the after effects of war and the cyclical depression of trade, are due, therefore, not to the enforcement of these claims but to the ***un-***

[31] *Vide* Charts, pp. 17, 32, 42, 50.

[32] *A. W. Kiddy:* New York Evening Post, October 29, 1921.

*certainties* of their possible enforcement."[33] Unless the exchange market is to be subject to fluctuations as wild and unpredictable as during the past year, it is imperative that the Reparations Commission find some method of remittance which will avoid the selling of large quantities of marks, and that the various countries reach a definite and final agreement which will silence all hopes for a "revision."

Aus der gegenwärtigen Unsicherheit entnimmt die Spekulation, die legitime des Rohstoffbeziehers und Importeurs wie die illegitime des Devisenhamsterers, heute ihren stärksten Anstoss; aus dieser Unsicherheit erwächst die Stimmung, dass es ja nur noch immer weiter bergab gehen werde. Wird sie beseitigt, so kann der Umschwung kommen. Und das wäre dann auch eine Voraussetzung—eine von vielen!—für eine Stabilisierung.[34]

In place of this uncertainty caused by an unreasonable settlement, it is essential to substitute a rational and permanently-workable solution. Under the present schedule of payments the German government must remit between one and two hundred billion paper marks each year. Since, even without the indemnity obligations the budget shows a substantial deficit, the treasury must resort to the Reichsbank for the full amount. The inevitable result is depreciation of the currency and consequent disturbance in the exchange market to readjust price levels.

In France, the prospect of receiving large sums from Germany is a powerful force of inflation. Instead of attempting to meet all expenditure by tax revenue, it is the settled and established policy of the French government to relegate all items of reconstruction and of post-war readjustment to a special budget "recoverable from Germany." In no year, however, has the amount of the indemnity yielded a sum which even approaches to the figure which France spent in anticipation of the reparations payments. With the hope of recovering at some future date, the full total of these expenditures, France has, for the present, resorted to advances from the Bank of France and to the sale of short-term government obligations. Inflation resulted. Thus, strangely enough, the indemnity payments in Germany and the prospect of receipts on reparations account in France have contributed to the depreciation of the mark on the one hand, of the franc on the other.

Event if the German government were able, by reviving the methods of the Inquisition, to raise by taxation the full amount of each yearly instalment, it would still have the greatest question in connection with the reparations problem to solve: how to effect payment. The only recognized media of international payments are gold or goods and services. Since the Reichsbank has already indicated its

[33] J. M. Keynes: A. Revision of the Treaty (London, 1922), p. 177.
[34] Frankfurter Zeitung, October 11, 1921.

unwillingness to part with the 995,000,000 marks of gold in its possession and since, in any case, this sum represents not quite one-sixth of the yearly requirements, the only alternative for the German government is to rely on an excess of exports of 6,000,000,000 gold marks. Under existing conditions, Germany's balance of trade shows a debit account of between ten to twenty billion paper marks. On the other hand, were Germany to increase her exports to an amount which would enable her to fulfill the requirements of the London agreement, she would have to raise her sales to foreign countries to 23,000,000,000 gold marks.[35] That by fostering German exports to this extent, the Allies will be crushed by an avalanche of German goods, their markets inundated by a flood of German manufactures, that for the Central Empires to "sling goods at us" in such quantities would be disastrous, that it would "shake the commerce of the world to its very foundations"—these and many other dire forebodings are the repeated warnings of the European and American commercial press. Barring the readjustments of the transition period, and provided the permanence of payment can be assured over a series of thirty to fifty years, it would, however, do the creditor countries as a whole, no harm to receive the German indemnity payments. If, to make the remittances, Germany must offer competitive goods at a lower price than she would otherwise, the particular industries in the Allied countries which produce these goods are bound to suffer. At first the injury to these industries will outweigh the benefit of the payments but, as in the course of time, the capital and labor are absorbed in other directions, the Allies together will perhaps gain a balance of advantages. In so far as the reparations payments accrue not to the nation with which German goods are competing, but to a third country, there are, of course, no advantages to offset the harm to particular industries.

To compel Germany to pay a large indemnity is to force her to expand her exports. The only way in which she can effect this expansion is by underbidding other countries in the world markets either by lowering the standard of living of the working classes or by subsidising her export industries at the expense of the rest of the community. Unless the Allies care to meet the German prices by reducing in corresponding degree, the standard of living of their labor, they will have to give up those branches of business which compete with the German industries. So painful is this process of driving capital and labor *en masse* from some types of enterprise to others that no government in the Allied countries would long remain in power which attempted to exact such an amount in reparations.[36] Since, in

[35] Before the war, German exports totaled 10,000,000,000 gold marks. Her balance of trade was unfavorable to the extent of 1,500,000,000 gold marks.

[36] *Cf.* J. M. Keynes: A Revision of the Treaty. London, 1922, *passim*.
C. A. Verijn-Stuart: Valuta und Schutzzoll, Frankfurter Messamt, *p. v. 3.*

case, whether or not the Allies demand the payment of an indem-
, the world will be subject to strong competition from Germany,
Allies would act more wisely if instead of fostering price cutting
underbidding, they would secure to themselves moderate payments
the scale, for instance, on which Germany would have been build-
up new foreign investments. A total of 30,000,000,000 gold
rks payable over a series of thirty years would be both within the
acity of Germany to give and the willingness of the Allies to
eive.[37]

In its bearing on exchange fluctuations, it is of small moment
ether international indebtedness represents inter-enemy or inter-
ed obligations. Just as the uncertainty about the amount and
ans of the reparations payment sways the exchange market to and
, so the indecisions concerning the future of the Allied debts causes
stant disturbances in the market for foreign bills.[38] Despite the
tude of Congress[39] and the third section of the Debt Funding Bill
ich expressly forbids cancellation, the sum of the debts owed by
Allies is so large, the burden of payment so heavy, that the Euro-
n countries continue to hope for at least a reduction of their obli-
ions to the United States.[40] "Although lying dormant these
igations of foreign governments are affecting every locality and
ry individual. . . . It is a tangled situation and such international
ilities, particularly in their unbusiness-like form, create uncertainty,
ke confidence and make resumption of normal business activity
ossible."[41] No less essential therefore than a definite solution of
indemnity problem is the final clearing and settlement of the inter-
ied debts.

r sehen also ein ungeheuerliches, verschlungenes Kreditsystem mit
hnung und Gegenrechnung, das ohne eigentliche Konsolidierung einer
estimmten Zukunft die endgültige Regelung überlässt. Die Verhält-
se rufen geradezu nach einem Welt-Clearing, das durch gegenseitige
frechnung der Finanzwirrnis ein Ende bereitet und zugleich für die
rderungssaldi die allmähliche Tilgung vorsieht.[42]

[37] *Cf.* J. A. Hobson: The Economics of Reparations, 1921.
J. M. Keynes: Consequences of the Peace, 1920.
J. M. Keynes: Revision o fthe Treaty, 1922.
H. Behnsen und W. A. Genzmer: Valuta-Elend und Friedensvertrag, 1920.

[38] *Vide supra*, pp. 32, 42.

[39] Cf. Hearings before the Senate Finance Committee on the Debt Fund-
Bill, S. 2135, June 1921.

[40] The suggestions, plans and schemes for cancellation or reduction have
n infinitely numerous. A full account of them is given in Friedman, *op. cit.*,
543-554.

[41] Assistant Secretary of the Treasury Wadsworth: Address, Baltimore,
ember 13, 1921.

[42] Frankfurter Zeitung: March 15, 1919.

Were the Allied governments called upon to pay only the current interest on their debts, the British Exchequer would have to find £50,000,000, the French Treasury would have to raise 4,250,000,000 francs and the Italian Finance Minister would have to provide 3,910,000,000 lire. In view of the fact that for the current year there is a deficit of £62,000,000 in Great Britain, of 15,000,000,000 francs in France and of 5,000,000,000 lire in Italy, the only way these governments can procure the sums needed for the service on their external debts is by discounting bills at their banks of issue. Although in no case does the interest on the foreign debt, if included in the budget, equal more than 40% of the deficit, nevertheless, by compelling the Allied Treasuries to borrow, in addition to their internal needs, the requisite sums for foreign debt charges, the exaction of payment would be a potent element of inflation.

Even if it be assumed that the European governments will succeed in balancing their budgets, even if they should be fortunate enough to raise in taxation funds sufficient to cover interest and sinking fund on their external debts they would have to find a method of remitting to the United States. Unless they are content to sell their local currency for what it will bring on the market and thereby produce the disastrous sequence of "catastrophe booms" and "improvement depressions" which Germany experienced, they must either obtain further credits, ship gold, or sell goods. Not only does the United States appear to have about reached the limit of its willingness to grant further loans,[43] but, as the service on past obligation mounts up, a time will come when fresh borrowings will hardly mee the interest charges.

Europe might pay in gold. It would, however, take a conside able amount of forcible persuasion on the part of the United Stat to compel European banks of issue to part with their specie reserve Despite the unprecedented flow of $530,000,000 gold to the Unite States from Europe during 1921, no European country—except Ge many and Holland—had reduced its supply of bullion by the end the year.[44] Practically the entire amount of specie which was shipp to the United States from Europe in the past year came from Indi South Africa and Russia. It is hardly probable that the Europe governments would deplete their reserves to meet the interest on the obligation to the United States when they did not even use their spec to pay for their excess of imports.[45] On the other hand, it is an op

[43] S. Stern: The Foreign Exchange Problem, New York, 1921.
Journal of Commerce, November 14, 1921.

[44] Annalist, January 9, 1922.

[45] For excess of imports of Great Britain *vide* Table IX, p. 160.
France *vide* Table X, p. 161.
Italy *vide* Table XI, p. 162.

question as to how much more gold the United States is willing to receive.[46]

By the shipment into the United States of all the bullion in the world and the erection there of a sky-scraping golden calf, a short postponement may be gained. But a point may even come when the United States will refuse gold, yet still demand to be paid—a new Midas vainly asking more succulent fare than the barren metal of her own contract.[47]

Only one method remains by which Europe can meet her debts; she must pay in goods. The same principles which apply to the demand for an indemnity from Germany hold for the exaction by the United States of the debts which the Allied governments owe. Not so much from the competition of cheap goods, however, will the industries of the United States suffer, as from the inability of the Allies to purchase from America their usual proportion of her exports. Rather by buying less than by selling more will the Allies try to find the money. Such a course would result in seriously crippling the export industries in the United States. For, to replace a favorable balance of trade running to $2,000,000,000 by an excess of imports of $600,000,000 as the United States must do if she is to collect even the interest on her debt, means untold suffering for the particular branches of our export trade. To judge from the loud and unrestrained complaints because of the mere reduction in our favorable balance of trade during 1921, it is not likely that the United States would pursue its policy of debt collection once it experienced the consequences. In fact, Congress is at present devising a tariff which will not only prevent the European countries paying their debts,[48] but which will even attempt to keep them from sending us goods to settle for their imports. Most certainly then it is not worth while to disorder our export industries and to disturb the equilibrium of our commerce for two or three years.

On the other hand, to cancel for all time the whole of the Allied indebtedness might be too much of a shock to the prestige and credit of the various countries. Given time, the European nations will regain strength; their investments abroad, particularly those of France in Russia, will conceivably again yield a return. A definite postponement of ten or fifteen years would afford the United States an opportunity to adjust her exports and imports gradually at the same time that it would give the European countries a chance to restore their commerce and their currency. At the expiration of this period, the Allied countries might pay the United States interest and sinking fund at the rate that her European debtors might otherwise be making new investments in foreign countries. By this arrangement, the European countries would be saved the humiliation of defaulting on their obli-

[46] Annalist, January 9, 1922.
[47] J. M. Keynes: A Revision of the Treaty, p. 164.
[48] Journal of Commerce, December 6 and 13, 1921.

gations; the United States would be enabled to collect its debts; yet commerce and trade would not be subject to the violent disturbances consequent on immediate collection; and the foreign exchange market would be relieved from the fluctuations resulting from the uncertainty of the future status of Allied debts, the danger of inflation and huge government operations in exchange.

In contrast to the indirect effects which the inter-Allied government indebtedness exerts on the exchanges the floating short-term obligations of the European countries influence the quotations of foreign bills in a most immedite and direct way. The $3,000,000,000 to $3,500,000,000 overhanging the market not only weigh heavily on the course of the exchanges and tend to check any advance,[49] but, when quotations have been carefully built up by manipulation, the pressure of these sales drives the prices of bills down again.[50] Before the exchanges can enjoy any degree of stability it is, therefore, essential that the European countries fund their short-term floating indebtedness.

### Trade Balance.

While a restoration of budgetary equilibrium and a re-establishment of sound banking are necessary requisites for a stabilization of the exchanges, a readjustment of the international trade balance is no less essential. Exports must, in the long run, equal imports. So long as a country has a net debit account in the international balance it must sell its currency for what it will bring on the world market. If a nation is to avoid the pressure on its exchange of this constant supply of bills, it must send out to other countries as much in value as it takes in.

> The state of the exchanges is in part the result of the depreciation in the purchasing power of the several currencies, but in part it results from the failure in exports. Many countries are temporarily dependent on the importation of food, raw materials, and other necessaries and are not in a position to furnish the requisite means of payment. The result has been severe competition for the very limited supply of bills of exchange, which has forced down the rate of exchange beyond the point which probably represents the purchasing power of currencies in buying and selling countries. . . . The ultimate cure is to raise exports to the requisite amount, and this should be impressed upon the trade communities affected.[51]

In view of the great destruction of wealth resulting from the war and the reduced efficiency of labor,[52] it is imperative that the world pro-

[49] Journal of Commerce, February 6, 1922.

[50] *Ibid.*, November 14, 1921. *Cf.* H. von Beckerath: Die Markvaluta (Jena, 1920), p. 12.

[51] Supreme Economic Council Report on Europe, March, 1920, in Willis, *op. cit.*, p. 6.

[52] *Cf.* Dr. Otto Lauts' investigation, Deutsche Wirtschaftszeitung, March 1, 1920. He concluded that "Die Arbeitsleistung beträgt also bei mehr als doppeltem *Lohn weit* weniger als die Hälfte der früheren Leistung."

ice goods with the least possible expenditure of effort. It is to the :nefit of all nations that each country specialize in the making of .ose goods in which it has relatively the greatest advantage.[53] The ldition obtained by employing labor and capital wherever they prove .ost efficient represents the benefits of commerce. If the advantages ·om trade are to be actually realized it is essential that the interchange f goods be unobstructed. Only under a regime of free trade is it ossible to reap the full yield of advantages accruing from specializa- on. In its price policy a country should not discriminate against ıe foreign market; for it then becomes impossible to value its cur- ency in accordance with its internal purchasing power.[54] At the ame time it is essential that, unless to protect scanty supplies of pri- ıary necessaries, import and export restrictions be removed.

'he Conference recommends that within such limits and at such time as ıay appear possible, each country should aim at the progressive restora- ion of that freedom of commerce which prevailed before the war, includ- ıg the withdrawal of artificial restrictions on, and discrimination of price gainst, external trade.[55]

CONVERTIBILITY.

If the European countries were to stabilize the internal value of heir currencies by balancing their budgets and righting their banking ituations, if they should settle the Reparations and inter-Allied obli- ations, and fund their floating indebtedness, and if they could attain n equilibrium in their international trade accounts, their exchanges 'ould move within fairly narrow limits. True, the market would still : subject to seasonal variations. But conceivably bankers might learn ' experience the nature of these tendencies and, by means of arbit- ıge, they would be able to counteract them. Nevertheless, with no old points to hem them in, exchanges would be liable to fluctuations 'om sudden demands due to accidental and unforeseen happenings.

[53] If two countries which traded together attempted, as far as was phys- ally possible, to produce for themselves what they now import from one ıother, the labor and capital of the two countries would not be so produc- re, the two together would not obtain from their industry so great a quan- y of commodities as when each employs itself in producing, both for itself ıd for the other, the things in which its labor is relatively most efficient. he addition thus made to the produce of the two combined constitutes the lvantage of the trade.—Mill, *op. cit.*, Book III, Chapter xvii, Sec. 3.

[54] The first condition to be fulfilled is that the present differentiation of ices in favor of the inland market or between foreign buyers of different ıtionalities should be completely abolished. The possession of a certain sum the currency of a country must represent the same right to buy on the in- nal market of the country, irrespective of the nationality of the possessor the money or of the destination he wishes to give to the commodities bought. this elementary principle is disregarded, it is vain to expect an international uation of the currency in accordance with its internal purchasing power.— ssel, *op. cit.*, p. 32.

[55] League of Nations, Official Journal, October 1920, p. 432.

Where, on the other hand, the gold movements act as a safety valve, the fluctuations of the exchanges cannot exceed the specie-points.

Despite the very scanty supply of gold in the European countries and the unlikelihood that a favorable trade balance will soon replenish their reserves, most of the European countries expect to return to the gold standard at some future time—however remote. "Whatever may be said from a theoretical point of view against the gold standard most countries look forward to a restoration of a gold standard as the real rescue from the hopeless muddle of the present paper money system. We must reckon with this desire as a matter of fact."[56]

Not without reason do the European countries hope to regain financial stability by the reintroduction of the gold standard. Recalling the smooth mechanism by which international payments were effected before the war, it will be better for nations to return to a system which experience has shown to be an efficient preventive of monetary disturbances, rather than to adopt an untried and uncertain method.[57]

Under present conditions of credit expansion, the world does not possess a quantity of gold sufficient to support the enormous paper structure built up during the war and post-war periods.[58] It is therefore essential that each country either by means of deflation or devaluation reduce its note and deposit currency to a level such that, when the gold supply is redistributed, each nation's share of the metal can, as in pre-war days, act as sufficient reserve for its notes and deposit liabilities.

Inevitably the re-establishment of the gold standard in European countries implies a redistribution of gold. At the end of 1913, the last pre-war year, the world's gold money supply was distributed about as follows: England had about $830,000,000 in her currency system; France had $1,200,000,000 in hers; Germany had about $916,000,000; Italy had $266,000,000; Japan about $142,000,000; Spain, $93,000,000; Argentina, $293,000,000; Russia, $1,012,000,000. The United States had about $1,905,000,000 in monetary gold. The rest of the countries in the world had varying amounts in proportion to their economic positions, making up the total of about eight billion in gold specie in the world.[59]

[56] Cassel, *op. cit.*, p. 34.

[57] It is imperative that the conditions necessary to the maintenance of an effective gold standard should be restored without delay. . . . Unless the machinery which long experience has shown to be the only effective remedy for an adverse balance of trade and an undue growth of credit is once more brought into play, there will be very grave danger of a credit expansion in this country and a foreign drain of gold which might jeopardise the convertibility of our note issue and the international trade position of this country.—Cunliffe Committee, August 1918.

[58] Willis, *op. cit.*, p. 8. *Cf.* pp. 121-130 on the progress in the banking situation in England, France, Italy, and Germany.

[59] *Annalist, January 9, 1922.*

In contrast to this position of stable equilibrium in the distribution in the world supply of gold is the unbalanced situation of today. With approximately $3,500,000,000 worth of gold in the United States, it is not possible for the European nations to have specie reserves adequate to support an amount of currency commensurate with their economic needs. On the other hand, it would be useless for the United States under present conditions to send gold to Europe either as a loan or as a gift. For due to her enormous excess of exports, the specie would immediately flow back. When, however, the European countries have checked inflation and have balanced their international accounts, it might be wise for the United States to deposit some gold in the European Central Banks as a means of hastening a return to convertibility and stable exchange conditions.

When the European states meet their expendtiures out of revenues, and the banks resume sound financial practises; when they definitely and unalterably settle Reparations and inter-Allied debts on a workable basis and rid themselves of their floating obligations; when their foreign trade has reached a state of equilibrium and their currencies are again safely anchored to specie, their foreign exchanges will again be stable.

# CHAPTER V.

## PROGRESS IN FULFILLING THE REQUISITES.

### Equilibrium of the Budget.

THE essentials of stabilization are neither "simple" nor "easily enforceable."[1] Together they present a complex and time-taking program difficult to attain. Yet, in the three years since the armistice, finance and trade have made sufficient progress to cause the apostles of gloom at Brussels and Washington some slight discomfort. Though it will be years, perhaps decades, before the commercial and financial equilibrium will rest again in the pre-war state of balance, every step toward greater soundness in currency and banking, every move toward a more equal distribution of trade means just that much progress in fulfilling the requisites of stabilization.

To turn from the extravagance of war finance to the more rigid demands of a peace budget, governments require time. They must liquidate the many war-created departments. They must demobilize both the military and civil service. With difficulty do they become convinced of the necessity of balancing their budgets. Only gradually do they wipe out the deficits inherited from war conditions.[2]

Against a debit balance of £1,682,000,000 in Great Britain in 1919 and of £326,000,000 in 1920, the budget for 1921 showed a surplus of £230,000,000, and for 1922 an estimated credit balance of £84,000,000. True, the figures do not call for interest payment on Great Britain's debt to the United States; 25.4% and 27.6% of the receipts in 1920 and 1921 respectively were represented by non-tax[3] revenue; the surplus of 1921 is partly the result of taxpayers' bank borrowings;[4] and the estimated credit account of £84,000,000 for 1922 must,

[1] Labor held that the government should enforce the measures for stabilization which had been proven "simple and easily enforceable." Economist, August 13, 1921.

[2] Mr. Chamberlain in looking forward to 1922-23 anticipated expenditure on the present basis (1921-22) of £950,000,000. "Clearly," he said, "that is too high and must be reduced. . . ." This would be very hopeful if it were not so belated and so reminiscent of similar promises, which have produced quite inadequate effects. Economist (London), Vol. xcii, p. 860.

*Cf.* the limited success of the recommendations of the Geddes Economy Committee: Arthur W. Kiddy, New York Evening Post, February 27, 1922.

*Cf.* also Vanderlip: What next in Europe? (New York, 1922), pp. 33 *et seq.* *Cf.* Table I, p. 152.

[3] Includes sales of surplus war stores, materials, foodstuffs.

[4] From the point of view of credit expansion there is no difference betweeen the government's borrowing direct from the bank and the taxpayer borrowing to pay the government.—London Joint City and Midland Bank, November 1920.

according to latest advices[5] be replaced by a £62,000,000 debit. Despite these qualifications, however, the United Kingdom has made tangible progress in reducing expenditure and in equating the two sides of her budget.

In attempting to find the basis for correct estimates, the Chancellor of the Exchequer worked out a model normal year to which he approximted the budget for each succeeding fiscal period. "Neither this year, nor next year, nor perhaps the year after, will be entirely normal and, in considering what our policy ought to be, I am driven to the hazardous experiment of casting my mind forward into the future to an imaginary normal year."[6] In this hypothetical post-war budget, revenue and expenditure balance at £766,000,000.[7] Despite the impatience of the British business world at the slow pace the Exchequer has attained in reducing expenditures,[8] Great Britain has cut down costs year by year since the armistice. From a high figure of £2,579,301,000 in 1919, the Chancellor succeeded in bringing expenses down to £1,655,773,000 in 1920 and to £1,184,000,000 in 1921; whereas for 1922 he has even kept ordinary outlay below the billion pound mark—though £66,000,000 special expenses will make the total £1,058,000,000.[9]

These heavy expenditures represent, in part, demands on the Exchequer that are temporary and sporadic; in part, they constitute ordi-

[5] Wall Street Journal, January 7, 1922.

[6] Statement by Austin Chamberlain, Chancellor of the Exchequer, quoted in Economist, Vol. lxxxviii, p. 768.

[7] GREAT BRITAIN.

Normal Post-War Year. (000 omitted).

| Revenue— Items— | Amount | Per cent. |
|---|---|---|
| Customs and Excise | 270,000 | 36.0 |
| Inland Revenue | 440,000 | 57.0 |
| Post Office | 43,000 | 5.0 |
| Non-tax Revenues | 13,000 | 2.0 |
| Total Revenues | 766,000 | 100.0 |
| Expenditures— | | |
| Consolidated Fund | 400,000 | 46.0 |
| Army and Navy Service | 113,000 | 17.0 |
| Civil Service | 190,000 | 30.0 |
| Revenue and Post-Office Service | 66,000 | 7.0 |
| Total Expenditures | 766,000 | 100.0 |

Source: Economist, Vol. lxxxviii, p. 769.

[8] The Economist comments on the Chancellor's speech in rather sarcastic vein:

The normal year is not to be the next year, nor necessarily the year after next, or even the year after that, but a financial period which somehow and somewhen, in a not altogether impossible future, may reward the pious aspirations of those true believers who always thought that the amount we spend ought to be no greater than the amount we raise.

Economist, Vol. lxxxviii, p. 769.

[9] Economist *(London)*, Vol. xcii, p. 859.

nary, recurring items that are permanent and almost irreducible. Of the latter the most weighty are Consolidated Fund Services and Supply Services. To the extent that interest for the post-war years falls short of the £400,000,000 mark set in the "imaginary budget" it represents additions to debt and consequent increases in future interest dues. In 1920 and 1921 this deficiency amounted to £24,000,000, and for 1922 to £29,000,000. On the other hand, Supply Services exceeded the allowances of the hypothetical post-war figures because in many respects the post-Armistice budgets have contained the unexpected and special charges due to the aftermath of war. Against an "imaginary" outlay of £110,000,000 representing 17% of the entire debit account, military cost consumed £502,700,000 of a total of £1,665,000,000 or 30% in 1920. For 1921, however, Great Britain spent only £230,-429,000 or 19.4% on armaments; and for 1922, the estimates call for £193,382,000 or 18.2% to be spent on army, navy, and air services.

Again the normal peace budget omits all the demands on the Exchequer which the Government's withdrawal from war-business made inevitable. During 1920, subsidies and temporary war charges totaled £182,000,000. The Government spent:

| | |
|---|---|
| £56,000,000 | on bread subsidy. |
| 32,000,000 | on coal subsidy. |
| 53,000,000 | on railway subsidy. |
| 8,000,000 | on unemployment benefits. |
| 4,000,000 | on Civil Service Bonus. |
| 5,000,000 | on land settlements. |
| 24,000,000 | miscellaneous. |

Though the prosperity of 1920-21 veiled the after-effects of war and therefore permitted a reduction of £72,000,000 in Supply Services, the readjustment and depresison in 1921-22 resulted in expense items to the Exchequer of £100,000,000 in connection with the return of the railroads to private owners;[10] of £20,000,000 for the coal strike,[11] and of an equal amount for the unemployment doles in the first half of the fiscal year.[12]

Not satisfied with merely reducing expenditure to equate income and outgo, the British Treasury has also broadened the basis of taxation. On spirits, Great Britain increased the excise 22s 6d a gallon; on beer, 30s a barrel. On wine, the Exchequer doubled the duties; on sparkling wines and cigars it placed, in addition, an extra 50%. The stamp duty on the transfer of shares was raised from 10s to £1 per cent. In accordance with the recommendations of the Select Com-

[10] Economist, Vol. xciii, p. 54.

[11] *Ibid.*, p. 44.

[12] Statement in House of Commons by Sir Robert Horne, Chancellor of the Exchequer, November 9, 1921.

ittee on National Expenditures for 1920, the Exchequer reduced the ıper-tax limit for income taxpayers from £2,500 to £2,000; at the .me time the Government enforced an increase ranging from 6d to ; 6d in the rates; this change brought the rate to 6s on incomes above 30,000 a year. Thus broadened and enlarged, the British tax sysm yields good results: "nearly all sources of revenue have been sur-isingly prolific. Income tax, customs, estate, excise have exceeded :pectations; only the Excess Profits Duty has fallen short."[13]

On crossing the Channel, conditions become more difficult. Not ıly is the fiscal situation in France troublesome, in and of itself, but :he manipulation and loose accounting in the presentation of bud-:tary information"[14] have multiplied the difficulty a hundred-fold. No one knows the total of our (France's) income, of our expen-.ture, or of our debt. For seven years there has been neither an :counting of the various departments nor of the total financial opera-ons of the State."[15] Figures have been published; but they are unfor-ınately not entirely reliable. "Tout d'abord, avant d'entrer dans le omaine des chiffres, il est nécessaire de signaler que l'exactitude à .quelle on peut pretendre est très relative."[16] According to the most ıthoritative guesses[17] the utmost achievement of the efforts of the rench Finance Ministry is a progressive reduction in budget deficits. [ot until 1930 will the credit and debit sides balance. By that date ıe total debt of France will stand at 427,000,000,000 francs.

[enri Chéron has recently predicted the future for us. Starting with debt of 328,000,000,000 francs on January 1, 1922, he foresees expendiıres of 110,000,000,000 francs up until December 31, 1929, or during the :xt eight years which will not be met by ordinary resources but will have come from German Reparations or from loans. This sum added to the 28,000,000,000 francs gives 438,000,000,000 francs. . . . Compute the terest on this at 5 per cent—you have over 21,500,000,000 francs, or :arly the total of the ordinary budget for 1922.[17]

To brighten this black forecast, there is but one spark of hope; ıat the deficit will, year by year, diminish. In the three post-war udgets of France there is some faint proof that she is making progress ı equating expenditure and tax-revenue. Although the estimated

[13] Statement in House of Commons by Sir Robert Horne, Chancellor of ıe Exchequer, November 9, 1921.

[14] *Cf.* Table II, p. 153: J. F. Bass & H. G. Moulton: America and the Balıce Sheet of Europe. New York, 1921, p. 50.

[15] French financial authority quoted in Journal of Commerce, February 17, 922.

[16] Budget Commission, Rapport General, France 1919, p. 59.

[17] Henri Chéron, Journal of Commerce, Febuary 17, 1922, Brussels Cor-:spondence.

deficits declined from 35,000,000,000 francs in 1920 to 16,000,000,000 francs in 1921, and to 12,000,000,000 francs in 1922,[18] the actual results yielded a debit balance for 1921 equal to that of 1920. The "saving" of 3,500,000,000 francs in the original estimates for 1921 as compared with 1920, resulted from a reduction in the reserve fund earmarked for the purchase of "Rentes" in the open market and from the omission of the interest on the loan to the United States. If these items are added to the 44,401,000,000 francs of expenditures, the debit sides of the budget for 1920 and 1921 are identical. These, however, do not includue all the expense items. The device of paying indemnities to the victims in the North and East by annual instalments instead, as before, in capital premiums, gave an apparent reduction of 5,000,000,000 francs. Also the estimates did not provide for the bread subsidy, the management of the merchant marine, the army of occupation and the meeting of the loans. Taken altogether, the account for 1921 will probably show a deficit of 35,000,000,000 francs.[19] Only slightly more hopeful are the revised estimates for 1922. Again this year, the budget commission "saved" 600,000,000 francs by cutting down the funds provided to support French Rentes in the security markets. The ordinary budget, as finally voted on January 1, 1922, showed, in spite of all reductions, a net debit balance of 1,320,000,000 francs. But the Treasury's motto is "ni impots, ni emprunts." To make the budget more pleasant reading, the commission, therefore, authorized the finance minister "for and to the equivalent of all Rentes received in payment of the tax on war profits to issue Treasury Notes and sell them." This is mere juggling with names. The deficit is rebaptized.

According to customary fiscal practice in France since the war, the special expenses of 19,000,000,000 francs are recoverable from Germany.[20] More than a few billions it will be impossible to collect this year. Summing up the items, the deficit, according to revised estimates, totals 21,000,000,000 francs. The accumulated results of

[18] These figures include expenses supposedly recoverable from Germany under the Peace Treaty.

[19] Journal des Débats, December 12, 13, 1920.

[20]

| Special Expense. | | Special Receipts. | |
|---|---|---|---|
| Credit National Loans.. | 8,000,000,000 | Reparations ........... | 12,000,000,000 |
| Group Loans .......... | 4,000,000,000 | Receivable from Germany this year....... | 4,500,000,000 |
| Direct Loans .......... | 7,000,000,000 | Product of marketing German reparation Bonds .............. | 2,500,000,000 |
| | 19,000,000,000 | | 19,000,000,000 |

(Wall Street Journal, Paris correspondence, January 28, 1922.)

such financing is a corresponding increase in the debt. To a total of 171,688,000,000 francs on December 31, 1918:

The year 1919 contributed 45,000,000,000 francs.
The year 1920 contributed 35,000,000,000 francs.
The year 1921 contributed 24,000,000,000 francs.

In this increase, the expansion of National Defense Bonds is particularly vicious:

On June 30, 1919, National Defense Bonds were 33,892,000,000 francs
On July 1, 1920, National Defense Bonds were 44,200,000,000 francs
On Dec. 31, 1921, National Defense Bonds were 63,700,000,000 francs

To judge from these figures, France will have to cut expenses more ruthlessly and apply taxation with less fear and hesitation before her budget will even begin to show a real and healthy reduction in deficits.

More than any other country, France burdens herself with armaments. Whereas, the 1920 cost for army and navy was 6,103,000,000 francs, for 1921 this figure rose to 7,400,000,000 francs.[21] The estimates for 1922 place military expenses at 4,821,000,000 francs; but unfortunately there is still time to increase this figure by the favorite method of French Finance Ministers, the "douzièmes provisoires." More weighty still and even more unavoidable are the debt services. In the ordinary budget, interest on the public debt consumes over 50% of the receipts. France spent 11,686,000,000 francs, or 53% of ordinary expenditures on debt services in 1920; in 1921, interest charges cost 10,243,000,000 francs, and 12,866,000,000 francs in 1922. In addition to the ordinary burdens of expense, France has had to rebuild the devastated areas. While waiting for Germany to pay, France has had to act as banker, and advance the funds to rehabilitate the North and East. On reconstruction she spent 20,000,000,000 francs in 1920 and 16,000,000,000 francs in 1921. For 1922, she expects to reduce this charge to 12,000,000,000 francs and for each of the following eight years to 9,000,000,000 francs.

The greatest possibilities for limiting expenditures are cutting down military costs, refunding the debt at a lower rate of interest and reducing to the least possible figure the sums needed for the war-destroyed areas. As it becomes more evident that the European countries will not be in a position to challenge her for some time, France does take steps to reduce both her own army and the forces

[21] 4,613,000,000 francs in the ordinary budget and 2,800,000,000 francs in the extraordinary budget.

she supports in other countries.[22] The government has provided fo cutting down the military forces from 818,000 on October 1, 1921 to 650,000 by the spring of 1922.[23] Again, as savings increase an capital costs come down, France, by moulding her debt according t the easier conditions in the investment market, will effect a saving i debt services.[24] Since approximately 60% of the devastated area are now rebuilt[25] expenditures on this account will soon diminisl Slow and trying though the process of continual saving is, expend tures, year by year, will decrease.

Equally difficult and just as time-consuming is it to increa: revenue. The Finance Ministry has made good progress in unearthir new sources of taxation.[26] A series of direct taxes, special ar general income taxes, business profits tax, estate and inheritance ta

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[22] The item "Treasury bills discounted" (included in Government secu ties) in the Bank of France statement are advances to other countries most for military purposes. On December 30, 1920, they amounted to 3,980,000,0 francs. *Vide* Table VI, p. 156.

[23] Associated Press, November 30, 1921.

[24] The 1922 budget provides for a saving from this source of 300,000,0 francs.

[25] J. M. Keynes: A Revision of the Treaty, p. 106.

FRENCH ESTIMATES APRIL 6, 1921:

| | Destroyed | Repaired |
|---|---|---|
| Houses totally destroyed | 319,269 | 2,000 |
| Houses partially destroyed | 313,675 | 182,000 |
| Railway Lines | 5,534 kilometres | 4,042 kilomet |
| Canals | 1,596 " | 784 " |
| Roads | 39,000 " | 7,548 " |
| Bridges, embankments, etc. | 4,785 " | 3,424 " |

| | Destroyed | Cleared | Levelled | Plough |
|---|---|---|---|---|
| Arable Land (hectares, 000 omitted) | 3,200 | 2,900 | 1,700 | 1,150 |

| | Destroyed | Reconstructed | Under Reconstructi |
|---|---|---|---|
| Factories at work | 11,500 | 3,540 | 3,812 |

[26] The tax law of June 25, 1920, provided for substantial increase taxation. The war profits tax rate of 50% on the excess over pre-war pro was abandoned. Business profits in excess of francs 5,000 were taxed the rate of 8%, agricultural profits above francs 4,000 were taxed at the r of 6%, and salaries and various forms of unearned income in excess of 4, at the rate of 6%.

The general income tax of 1917 was levied on all incomes in excess francs 3,000 over and above allowances for dependents. An estate t applicable only if there were three children or less, ranged from ¼ of to 3% on estates of francs 2,000 or less up to 7½ to 39% on the fraction ceeding francs 500,000 depending on the number of children. In addition heir must pay an inheritance tax ranging from 1% to 59% depending up the amount of the inheritance and the degree of the relationship. The co bined estate and inheritance taxes shall not exceed 80% of the property ceived by any heir.

Of the indirect taxes, the tax on sales is the most important, levied the rate of 1-1/10% on the net sales of merchants and on the gross prof commissions, interest and other charges of bankers and brokers. In ad tion there were enacted a great number of stamp, excise, consumption a *luxury taxes.*—Friedman, *op. cit.*, p. 120.

provided for increased revenue, as did also the sales, stamp, consumption and excise taxes. So exhaustive did the Finance Minister regard the tax system that he thought it "impossible to add to the financial sacrifices of the nation by further increasing taxation."[27]

But the French fiscal net has very wide meshes. It is more open than it ought to be.[28] In consequence, tax receipts fall short of the estimates. In 1920, only 529,000 persons filed income tax declarations; in 1921 it was disclosed among other things that at present there are more people in France paying taxation in respect of touring cars than there are income tax payers.[29] The turnover tax lacked 1,000,000,000 francs in 1920;[30] customs yielded only 1,192,000,000 francs instead of the hoped-for 2,024,000,000 francs.[31]

In view of the laxity in enforcing tax payments which these comparative figures indicate, the Finance Ministry decided for 1922 to enforce the present taxes with greater severity before imposing new ones.[32] The basic trouble with the French budget is, however, political. Public opinion in France demands that Germany bear the entire war expenses, consequently each successive Finance Minister lays more stress on Reparations than on a rigid collection of taxes or on the need for public economy. "Germany can pay and must be made to pay, otherwise France's position is insoluble."[33]

Not burdened by the need for reconstructing devastated areas and more willing to tax herself,[34] Italy[35] expects to balance her budget by 1924. With Nitti's reforms as a foundation, Giolitti's measures[36] succeeded in reducing the estimated deficit from 8,830,000,000 lire in 1920[37] and 14,000,000,000 lire in 1921 to 9,710,000,000 lire for 1922 and 3,000,000,000 lire in 1923. These estimates in themselves would

[27] Statement of the Finance Minister, Economiste Français, November 3, 1920: It is impossible to add to the financial sacrifices of the nation by further increasing taxation which since the beginning of the war has increased by the enormous annual figure of 11 milliards.

[28] Economist, Vol. xciii, 261 (1921).

[29] Economist (London), February 18, 1922.

[30] Bulletin Economique, October 27, 1920.

[31] Journal of Commerce, February 17, 1922.

[32] *Cf.* the motto of the Budget Law passed January 1, 1922, "ni impots, ni emprunts."

[33] M. Chéron Budget Speech, Economic Review, vol. iii, p. 369. *Cf.* Temps, April 14, 1920: "If the Allies did not leave France to bear the expenditure chargeable on Germany, France would experience no serious difficulties in years to come providing the ordinary budget was adjusted by means of taxation and economies."

[34] Economist (London), vol. xciii, p. 298. *Cf.* F. A. Vanderlip: What next in Europe? p. 40. "My observation was that Italy was collecting taxes with a firm hand. Her income each month runs ahead of the anticipated receipts and no one seems to escape easily from the collector."

[35] *Vide* Table III, p. 154.

[36] *Vide infra,* p. 114.

[37] Does not include 6,300,000,000 lire for bread subsidy.

not be disheartening. They would show that Italy was making slow progress in reducing her deficit. The actual returns, however, are even better than the forecasts. Italy has had the unique and novel experience of over-estimating her deficits. Whereas for 1921, the Finance Minister expected to borrow 13,430,000,000 lire, the actual results of the year showed a debit account of only 10,712,000,000 lire. For 1922 the most recent figures indicate a deficit of 4,000,000,000-5,000,000,000 lire, against an original estimate of 9,710,000,000 lire.

Better than almost any other country, Italy has understood the need for cutting down expenses on armaments. Whereas in 1920, Italy spent 7,409,000,000 lire, or 50% of her total revenue for military outlay, the ministry of war was allotted only 3,948,000,000 lire in 1921 and 2,866,000,000 lire in 1922. Upon an army of but two-thirds the pre-war strength, each Italian taxpayer spends $6.34, whereas the per capita cost in France is $10.24.[38] Debt services require but 4,181,000,000 lire,[39] or approximately 35% of the ordinary expenditures. Her reconstruction work Italy is able to carry on at the low cost of 1,000,000,000-2,000,000,000 lire.[40]
The largest single item in the budget is the bread subsidy of 6,300,000,000 lire per year. Even this the government has been able to reduce. By the law of February 27, 1921, which increased the price of bread, the treasury effected a saving of 5,300,000,000 lire.[41]

Not content with a mere reduction in expenditure, Italy has completely reformed her tax system.[42] "There is not a single tax which has not been re-imposed and largely increased; new taxes have been devised and prices of monopoly articles have been increased."[42] Nitti first reduced the floating debt by issuing a voluntary loan which funded 12,000,000,000 lire of the short-term obligations and brought 6,000,000,000 lire cash into the Treasury. To pay the interest on this debt he instituted a levy on capital extending over thirty years. In order to increase tax revenue, he introduced a tax of 10% to 50% on war profits, and an income tax which, beside the graduated basic charge on income, levied an extra tax, also graduated, on the entire income of a family.[43] As a complement to these direct taxes, the

[38] Table compiled by the Wall Street Journal, December 20, 1921.

[39] F. Meda, Minister of Finance Statement, Chamber of Deputies, December 19, 1920.

[40] *Ibid.*

[41] Statement of M. Nava, Chamber of Deputies, July 26, 1921.

[42] Frankfurter Zeitung (Rome correspondence), October 20, 1920.

[43] "This extra tax was a minimum of 1 per cent on a family's income of 1,500 lire, increasing to 25 per cent on an income of 2,500,000 lire. On the other hand, in accordance with the usual Italian methods, it remained the same for all income classes of the same category, viz., 18 per cent on unearned income, 15 per cent on income from business undertakings, and 12 per cent on income earned by personal exertions.—Economic Review, Vol. ii, *p. 569.*

government re-imposed several old taxes and stamp duties, e. g., dues on chemists' and registration fees, and raised luxury taxes.

Even severer were Giolitti's reforms. The most important of his measures is the compulsory registration of bearer securities. All securities, without exception, shares, debentures, government loan stock, were to be turned into bearer securities amounting, when capitalized, to 70,000,000,000 lire. In addition, Giolitti placed an increased graduated scale on death duties; introduced the complete attachment of all war profits, and increased the tax on motor-cars. How difficult it is to enforce such severe tax legislation is evidenced by the fact that, due to the political situation, neither the law for compulsory registration of bearer bonds[44] nor the general taxation reform of 1919, based on the progressive income tax, have been enforced.[45] As in France, the Finance Minister believes that tax measures have reached the limit of productivity. "Quanto al probabile andamento delle entrate nei più prossimi anni, il ministro non si dissimula che tenuto conto della pressione tributaria che pesa sui contribuenti non sia dato fare grande assegnamento sopra larghi proventi di entrate ordinarie per nuovi tributi e per inasprite forme di tassazione."[46]

Because of her efficient methods in collecting taxes, actual revenues have exceeded estimates even without the application of the severer tax measures. In 1921, the Treasury's efforts were rewarded by an increase of 1,750,000,000 lire in revenue.[47] By cutting down, one after another, her items of expenditure and by devising new taxes and new means of enforcing old ones, Italy will probably be able within two years to live within her income.

Almost hopeless, in comparison, is the position of Germany.[48] Not only do the state accounts, as in Italy and France, show an annual debit balance; but instead of being able to set a definite date when the government will spend no more than it takes in, the German deficit increases at an ever more rapid and ever more uncertain pace. To crown all the difficulties of accumulating expenditures, the Finance Minister never knows how much his income or outgo will be by the end of the year.

In every budget nowadays there is the objectionable feature that the denominator by which all revenues and expenditures are reckoned continuaally fluctuates. Since depreciation is continually increasing, it may confidently be predicted that the figures in the expenditure column will be

[44] Decree of August 1, 1921, suspended the application of the regulation.

[45] Enforcement of 1919 law postponed until 1923. Federal Reserve Bulletin, February, 1922.

[46] Sig. Nava, Chamber of Deputies, July 26, 1921. (Corriere della Sera, July 27, 1921.)

[47] Federal Reserve Bulletin, February, 1922.

[48] *Cf.* Table IV, p. 155.

exceeded, but it is extremely doubtful if revenue will increase pari passu with the depreciation of the currency.[49]

Since Peace was signed in June, 1919, the debit balance of the German Treasury has risen to fantastic heights. For 1920, the deficit was 10,000,000,000 marks;[50] the next year it rose to 74,855,000,000 marks.[51] By 1922, expenditures uncovered by revenue reached 161,000,000,000 marks;[52] and the estimate for 1923 indicates a deficit of 216,000,000,000 marks.[53]

From these deficits, running into the hundred billions,[54] it might appear that Germany was indulging in riotous extravagance. The expenditures under existing conditions, are, however, largely inevitable. For debt services Germany spent 10,000,000,000 marks in 1920, 12,000,000,000 marks in 1921, and 15,000,000,000 marks in 1922. Armaments cost only 1,900,000,000 marks, or 11% of the total in 1920; 2,900,000,000 marks, or 3%, 1921, and 3,225,000,000 marks, or about 2%, in 1922. Expenses due to the after-effects of war form a heavier, though by no means irreducible burden. The loss on the posts and railways was 24,000,000,000 marks in 1921 and 40,000,000,000 marks in 1922. For 1923, as a result of repeated increases in rates, the estimated deficit is only 8,000,000,000 marks. The bread subsidy cost about 10,000,000,000 marks for 1921 and 1922. An increase in the price of bread on February 16, 1922, saves 6,000,000,000 marks on this item.[55] The constant rise of prices causes ever-varying and unavoidable expenses for increase in wages and salaries for public servants. Most burdensome, by far, are the expenditures in connection with the Versailles Treaty. For the execution of the Peace Treaty, Germany spent 42,000,000,000 marks in the year ended March 31, 1921; 112,900,000,000 marks in 1922; and, according to estimates, 228,000,000,000 marks for 1923.

The revenue program is complex and burdensome.[56] In 1919, the sales-tax was raised. Practically everything, except the most essential goods, was taxed from 1% up to 15%. The income tax, effective April 14, 1920, applies to individuals, allows an exemption

[49] Deutsche Allgemeine Zeitung, October 23, 1920.

[50] Commerce Reports, November 12, 1919.

[51] Frankfurter Zeitung, June 28, 1921.

[52] Federal Reserve Bulletin, 1921, p. 958.

[53] Wall Street Journal, December 30, 1921.

[54] It must be noted that these figures are highly inflated because of the depreciation of the currency. At existing rates of exchange (taking the franc at $.08 and the mark at $.005) the German deficit of 216,000,000,000 marks is approximately 14,000,000,000 francs and the French deficit of 21,000,000,000 francs equals 336,000,000,000 marks.

[55] Federal Reserve Bulletin, February, 1922.

[56] *Karl Brauer,* Finanz- und Volkswirtschaftliche Zeitfragen, p. v. 69.

f 1,500 marks for each person and is levied on a graduated scale.[57] Jnearned income is specially taxed at a rate of 10% and is paid at ie source.[58] Income which increased between 1914 and 1919 by 0,000 marks or more pays, in addition, a tax of from 5% to 70%.[59] 'o correspond to the tax on income of individuals, corporation rofits[60] bear a normal tax of 10% and surtax of 2% to 10%. Propery did not escape its share of the burden. In addition to the warvealth levy[61] and the capital levy[62] the Reichstag provided for reurrent taxation on the increases of wealth at intervals of three years.[63] 'o make sure that it had overlooked no available source of income, he government passed a law on September 1, 1919, taxing inher:ances.[64]

Together these taxes represent a contribution of over 16% from ie annual earnings of the lower classes, whereas in Great Britain the orresponding burden is 7% to 8%.[65] In the higher classes, taxation as almost become tantamount to confiscation.[66] A taxpayer whose

[57] Actual rate for a few selected classes on income.

| Income— | Tax on unmarried | | Tax on married with 5 children* | |
|---|---|---|---|---|
| Marks | Marks | Rate per cent | Marks | Rate per cent |
| 2,000 | 50 | 2.5 | 0 | .... |
| 4,000 | 270 | 6.7 | 0 | .... |
| 6,000 | 530 | 8.8 | 50 | 0.8 |
| 10,000 | 1,170 | 11.7 | 675 | 6.7 |
| 50,000 | 13,060 | 26.1 | 10,980 | 22.0 |
| 100,000 | 33,625 | 33.6 | 32,275 | 32.3 |
| 500,000 | 252,115 | 50.4 | 250,345 | 50.1 |
| 1,000,000 | 552,100 | 55.2 | 550,300 | 55.0 |

* Exemption of 500 marks for each dependent.

[58] Law effective March 31, 1920.

[59] Law effective September 10, 1919.

[60] Law effective April 15, 1920.

[61] Law effective September 26, 1919.

[62] Law effective July 26, 1918.

[63] Law effective April, 21, 1920.

[64] Law effective September 1, 1919.

[65] Frankfurter Zeitung, September 22, 1920.

[66] "During the last few days, I have had an opportunity of being acquainted ith the burden of taxation imposed upon a Mannheim manufacturer, whom knew personally. This gentleman has invested his entire fortune in his busiess, and before the war his fortune amounted to about 500,000 marks and ielded an average annual income of 50,000 marks. During the last few years, wing to the boom, he was able to increase his fortune to about 1,000,000 arks, and his income to 100,000 marks. The taxes payable by him for 1920 re as follows:

(1) War tax for 1919 on excess income of 50,000 marks.......... 7,500

(2) War tax on increased fortunes. On an increase of 500,000 marks, the tax is 283,000 marks. As this cannot be suddenly withdrawn from the business, payment must be made in twenty annual instalments. The instalment to be paid for 1921 amounts to ..............................................14,150

Interest at 5% on the unpaid instalment amounts to 13,442 marks; for 1920 only one-quarter of this is due, viz........... 3,360

(3) The Emergency Levy on a fortune of 1,000,000 marks; as the fortune is invested in an industrial concern only 80% of the

pre-war capital was 2,500,000 marks and who doubled it during the war, must pay 2,328,030 marks war-wealth levy and 1,004,500 marks under the emergency levy. Of the remaining return, he must pay an income tax of 26,439 marks and a tax on income from investments of 8,337 marks. His net income, after paying direct taxes, is 48,599 marks, against a pre-war income of 250,000 marks. Meanwhile, the rise in prices to forty times—which is but a veiled form of taxation—the 1913 figure reduces the real value of the remainder of his return to 2½% of his pre-war income; whereas the taxes on tobacco and cigarettes, sugar and salt, on alcohol, vinegar, wine, champagne and mineral water, on illuminants and matches, and the stamp taxes on playing cards, contracts, dividends, securities, lottery tickets, sales of merchandise and insurance, as well as the taxes on coal and post and telegraph service[67]—all these cannot fail to convince him that the legislators, at least, have "taken a fanatical delight in taxation as the noblest demonstration of patriotism."[68]

Unmindful of the fact that taxation is trenching not only on savings but even on capital, the German government has proposed a reform of the tax system to include no less than forty-four different kinds of taxes.[69]

sum, i.e. 800,000 marks, is taxable. The Levy amounts to 87,000 marks. As this too will be paid in thirty instalments, together with interest on amortisation, 6.5% of 87,000 marks has to be paid, i.e. .......... 5,655
(4) State and Communal taxes for January, February and March .. 14,913
(5) Taxes on landed estate, buildings and the industrial tax (nine months) .......... 13,965
(6) Church rate .......... 1,349
(7) State fire insurance and subscription to Chamber of Commerce .. 1,200
(8) Commonwealth income tax on an income of 100,000 marks deducting taxes enumerated above amounts to 18,000 marks or for nine months .......... 13,522

Total...... 75,615

Accordingly out of an income of 100,000 marks, only 24,384 remains. In view of the high prices of additional necessary expenditure, this income is insufficient, and some 25,000 or 35,000 marks will have to be withdrawn from the business."

—Report of Dr. Engelhard, President Mannheim Chamber of Commerce, to Baden Handelstag, Welthandel, July 9, 1920.

[67] Friedman: *op. cit.*, p. 163.
Karl Brauer, Finanz- und Volkswirtschaftliche Zeitfragen, p. v. 69.

[68] Dr. A. Feiler, Frankfurt Chamber of Commerce, Frankfurter Zeitung, May 2, 1920. "Germans must work, practise economy and show a fanatical delight in taxation as the noblest demonstration of patriotism."

[69] Following table shows in marks (last six figures omitted) increased receipts expected under proposed tax laws and now before the Reichstag for discussion:

| | 1922-23 | 1921-22 |
|---|---|---|
| Income tax | 23,000 | 20,000 |
| Corporation tax | 4,000 | 2,000 |
| Interest and dividend tax | 1,530 | 1,400 |
| Emergency levy (Reichsnotopfer) | 8,000 | 10,000 |

Were the Finance Minister actually able to enforce the complete collection of all these taxes, not only the income but the greatest part of property would pass to the Government. Although receipts are higher than the estimates, this is not due to real increases in tax-yield, but rather to the depreciation of the currency. The monetary inflation, in turn, is the result of previous government deficits. So long as Germany cannot meet all her expenditures, both ordinary and extraordinary, by tax revenue, she must continue to pile up deficits, and piling up deficits to inflate her currency.

| | | |
|---|---|---|
| Property tax | 20 | 25 |
| Inheritance tax | 700 | 620 |
| Sales tax (excl. restaurant tax) | 24,000 | 9,000 |
| Luxury restaurant tax | 500 | ..... |
| Ground purchase tax | 550 | 500 |
| Taxes on capital transactions: | | |
| a. Corporation tax | 1,067 | ..... |
| b. Taax on shares and stocks | 117 | ..... |
| c. Tax on stock exchange transactions | 1,075 | ..... |
| d. Tax on boards of companies | 50 | ..... |
| e. Tax on profesional purchases | 50 | ..... |
| Automobile tax | 125 | 3 |
| Insurance tax | 330 | 120 |
| Tax on racing bets | 215 | 100 |
| Lottery tax | 60 | 100 |
| Stamp tax on bills of exchange | 30 | 20 |
| Stamp tax on bills of lading | 100 | 100 |
| Levy on passenger train service | 1,000 | 1,800 |
| Levy on freight train service | 1,600 | 1,800 |
| Total from continual direct taxes | 68,120 | ..... |

Tax on capital increases, war levy on property increase, extraordinary war levy of 1918, addition to extraordinary war levy 1916 and tax on increment of wealth of after-war period (occasional direct taxes):

| | | |
|---|---|---|
| Total | 3,000 | 2,000 |
| Custom duties | 4,700 | 4,400 |
| Coal tax | 10,150 | 5,800 |
| Tobacco tax | 3,500 | 3,000 |
| Beer tax | 1,000 | 165 |
| Wine tax | 500 | 450 |
| Tax on sparkling wines | 100 | 100 |
| Tax on mineral waters | 60 | 40 |
| Tax on takings of spirit industry | 1,748 | 570 |
| Levy on consume of vinegar assets | 47 | 10 |
| Sugar tax | 1,000 | 160 |
| Salt tax | 60 | 80 |
| Tax on matches | 110 | 70 |
| Tax on lighting material | 60 | 15 |
| Tax on playing cards | 10 | 10 |
| Statistical fees | 13 | 1 |
| Takings of the Sweet-Stuff-Monopol (Sacharine) | 100 | ..... |
| Total custom duties and taxes on consumption | 23,158 | ..... |

From export duties the finance ministry expects 700,000,000 marks, just as before.

(Wall Street Journal, Berlin Correspondence, December 30, 1921.)

## Sound Banking.

Despite the legacy of war finance and the difficulties of the transition period, the banking position of Great Britain gives marked, tangible evidence of improvement.[70] Whereas the Weekly Returns[71] of August 4, 1920, still showed the full effects of government manufacture of credit, the statement for May 25, 1921, reflected both the success of deflation and the credit balance of £230,000,000 in the budget.

Compared with July 22, 1914, the position of the Bank of England on August 4, 1920, showed that:

(1) The Note Circulation (notes issued by Issue Department, less notes in Banking Department) increased by £97,171,785.

(2) The amount of gold coin and bullion held by the Bank of England in the Issue Department increased by £82,965,050 (nearly one-half of which was transferred from the Joint Stock Banks). In the Banking Department, the amount of gold and silver coin decreased by £21,216.

(3) Public Deposits increased by £3,727,061, and Other Deposits by £88,500,501, making a total increase in deposits of £92,227,562. The greater part of the increase in "Other Deposits" was due to increase in the balances of the Joint Stock Banks at the Bank of England.

(4) Government Securities increased by £65,260,814 and Other Securities by £41,155,803, making a total increase in securities of £106,416,617.

[70] *Cf.* Table V. Statist., Vol. xcviii, p. 394.

[71] The following explanatory remarks may be of some assistance in reading the returns: the item "Public Deposits" represents balances standing to the credit of various Government Departments. The item "Government Securities" includes Government obligations for temporary loans made to it, usually known as Ways and Means Advances. The item "Other Deposits" includes the balances standing to the credit of the other banks and to its other customers. And the item "Other Securities" includes securities deposited by its various customers other than the Government for loans made or credited to them. Now, a most important point to note about the Central Institution is that advances made by it do not usually entail withdrawals of legal tender, unless there is a greater demand for legal tender by the public, or the other banks withdraw some to strengthen the reserves in their own strong rooms. Occasionally gold is withdrawn from the Bank of England for export. Whoever obtains an advance from the Bank of England, whether it be the Government, an institution, or member of the money market or of the public, the drafts drawn against the advance will generally be paid into the other banks, because they are the bankers of the general public. The drafts are later paid into the Bank of England by the other banks to their own credit. It may therefore be said that advances by the Bank of England simply involve, in the main, entries in its own books, and the final result is an increase in the balances of the other banks.—Kirkaldy, *op. cit.*, p. 47.

(5) The Banking Reserve (notes, gold and silver coin in Banking Department) decreased by £14,227,951 (£12,408,474 of this decrease took place since July 30, 1919), but if expressed as a proportion of the total deposit liabilities, it fell from 52% to 10%.

(6) Seven day and other bills increased by £1,685.[72]

The great increase of £106,416,617 in "Securities" is but the statistical expression of the extent to which the Bank of England used its credit-manufacturing power. By May 5, 1921,[73] the position of the Bank of England had improved materially:

(1) Notes in circulation, increase £1,318,585.

(2) Gold coin and bullion (Issue Department), increase £5,011,455; gold and silver coin (Banking Department), increase £229,917.

(3) Public Deposits, decrease £1,043,037; other Deposits, decrease £18,625,515; total deposits, decrease £19,668,552.

(4) Government Securities, decrease £38,159,818; other Securities, increase £14,351,319; total securities, net decrease £23,808,499.

(5) The Banking Reserve, increase £3,922,787, the Reserve representing 15% of the total deposit liabilities, as against 10% on August 4, 1920.

These changes indicate genuine progress in the position of the Bank of England. Not quite so encouraging are the returns for February 8, 1922. During this period, the government has to meet a probable net deficit of £62,000,000, whereas it receives the bulk of the income tax return only in the last quarter of the fiscal year and must meanwhile borrow in anticipation. As a result of dull trade conditions, taxpayers must themselves rely on their banks. The combined demands of the Exchequer and the public are reflected in the Bank's Returns. Deposits are larger by £40,000,000 and securities by £35,000,-

[72] *Cf.* Table V, p. 156.

[73] Bank of England, May 5, 1921.

Banking Department

| Liabilities | | Assets | |
|---|---|---|---|
| Proprietors' capital | £ 14,553,000 | Government Securities | £ 38,106,122 |
| Rest | 3,193,391 | Other Securities | 89,139,884 |
| Public Deposits | 16,419,417 | Notes | 17,183,255 |
| Other Deposits | 112,060,283 | Gold and silver coin | 1,808,632 |
| Seven-day and other bills | 11,802 | | |
| | £146,237,893 | | £146,237,893 |

000 (Government securities increase £44,000,000, Other securities decrease £9,000,000).[74]

The counterpart of the Bank of England Returns is the combined Balance Sheet of the Banks of the United Kingdom. By 1919 this showed an increase of £1,328,000,000 in Credit Balance Liabilities to customers, an increase of £271,000,000 in their so-called Cash Reserves (usually described on balance sheets as cash in hand, at Bank of England,[75] etc.), an increase of £389,000,000 in Investments, an increase of £208,000,000 in Bills Discounted, and an increase of £501,-000,000 in Advances. "All these increases prove that there has been considerable credit inflation since the commencement of the war, and that the banking position at the end of 1913 was considerably better than that ruling at the end of 1919."[76] During 1920, while the Bank of England was steadily bettering its position, the Joint Stock Banks could not effect any considerable reduction on account of the financial difficulties of customers. The Balance Sheet shows on the side of liabilities an increase in:

(1) Paid up capital of £22,000,000.

(2) A reduction of over £48,000,000 in acceptances on behalf of customers. This reduction was due to the slump in trade, which commenced about July, 1920, and the great fall in wholesale commodity prices, which commenced in April, 1920.

(3) An increase of about £150,000,000 in the aggregate of credit balances, which the assets clearly prove to have been due to further credit expansion.

[74] Bank of England
Week ended Wednesday, February 8, 1922.
Issue Department.

| | | | |
|---|---|---|---|
| Notes issued | £145,375,585 | Government debt | £ 11,015,100 |
| | | Other Securities | 7,434,900 |
| | | Gold Coin and Bullion | 126,925,585 |
| | £145,375,585 | | £145,375,585 |

Banking Department

| | | | |
|---|---|---|---|
| Proprietors' Capital | £ 14,553,000 | Government Securties | £ 82,223,688 |
| Rest | 3,475,658 | Other Securities | 80,425,481 |
| Public Deposits | 14,721,329 | Notes | 22,708,830 |
| Other Deposits | 154,413,877 | Gold and Silver Coin | 1,822,775 |
| Seven-day and other bills | 16,910 | | |
| | £187,180,774 | | £187,180,774 |

[75] These cash reserves at the Bank of England are largely the result of the credit manufactured on Government account.

[76] Kirkaldy, *op. cit.*, p. 57.
Figures published by The Statist, May 15, 1920, and May 21, 1921.

On the side of assets:

(1) A reduction of £47,000,000 in investments. This decrease was due to reduced holdings of investments and sums written off for depreciation.

(2) An increase of £75,000,000 in bills discounted, presumably due to increased holdings of Treasury Bills, for the slump in trade and great fall in wholesale prices during 1920 probably caused some reduction in holdings of trade bills.

(3) And an increase of £140,000,000 in advances. This large net increase was due to further expansion in credit during the first six months of 1920.

Since business men held large stocks of high-priced unsaleable goods and received numerous cancellations, they felt the strain of delay in foreign remittances. The increase in advances proves that the banks supported their customers; "at all times when there is stickiness in the usual normal flow of credit there is a tendency for bank advances to increase."[77] Taking the banking situation in Great Britain as a whole, there can be no doubt that both for the Bank of England and the Joint Stock Banks, the returns indicate steady improvement.

In comparison with Great Britain, France has made but snail-like progress in righting her banking situation. During the last seven years, the Bank of France was compelled to finance the government to a much greater extent than the Bank of England. At the signing of the Armistice, advances to the Treasury constituted 50% of the total assets of the Bank. The success of any policy of deflation which the Directors of the Bank would wish to pursue depends, in a large measure, on the condition of government finances.

Since the French budget has suffered from large and continuous deficits[78] the financial situation has grown steadily worse. The Returns of the Bank for December 26, 1919, when compared with the pre-war condition, showed that:

(1) Metallic reserve increased 1,080,000,000 francs.
(2) War advances increased 25,500,000,000 francs.
(3) Loans and discounts decreased 1,157,000,000 francs.
(4) Advances increased 705,000,000 francs.
(5) Deposits increased 2,176,000,000 francs.
(6) Bank notes in circulation increased 30,591,000,000 francs.

The growing weakness in the financial condition of France caused the Governor of the Bank to impress upon the Minister of Finance

[77] Kirkaldy, *op. cit.*, p. 95.

[78] *Vide* Tables II and VI, pp. 153 and 157.

the urgent need for bringing down the advances on government securities. On April 14, 1920, the Treasury reluctantly agreed to reduce these advances to 24,000,000,000 francs by January 1, 1921.

Despite the arrangement, "War Advances" did not decline. The government postponed the contract. Throughout 1920 inflation continued. The result was that by December 30, 1920:

(1) Metallic reserve decreased 79,000,000 francs.
(2) War advances increased 1,100,000,000 francs.
(3) Loans and discounts increased 2,024,000,000 francs.
(4) Advances increased 738,000,000 francs.
(5) Deposits increased 391,000,000 francs.
(6) Bank Notes increased 628,000,000 francs.

Still the Treasury made no serious efforts to reduce its demands on the Bank. During the first months of 1921, advances to the government continued to increase. By May they had reached 26,700,000,000 francs. Reminded at frequent intervals of its agreement of April, 1920, which was renewed on December 29,[79] the government finally began to reduce loans at the Bank. Not only did this permit the Central Institution to contract its note circulation but, combined with the world-wide business depression, it enabled it to pursue a moderate, though at times hesitant, policy of deflation. By December 31, 1921:

(1) Metallic reserve decreased 464,000,000 francs.
(2) War advances decreased 3,264,000,000 francs.
(3) Loans and discounts decreased 846,000,000 francs.
(4) Advances increased 48,000,000 francs.
(5) Deposits increased 1,929,000,000 francs.
(6) Bank notes decreased 1,422,000,000 francs.

These figures indicate that the Bank of France has inaugurated a slow, moderate policy of checking further inflation.

An analysis of the position of the leading private banks substantially bears out this conclusion. Their reports indicate:

(1) Sharp contraction of advances on collateral.
(2) Sharp fall in debit current accounts.
(3) Decline of deposits and credit current accounts.
(4) Increase of commercial bills and Treasury bonds.

[79] Economiste Français, May 7, 1921.

he contraction[80] in advances on collateral, debit current accounts ıd deposits is the reflection of the business depression and of the ıutious and conservative attitude of French bankers. The rise in the em "Bills and Treasury Bonds" is mainly the result of the largely ıcreased investments in National Defense Bonds. Just so long as ɔvernment expenditures are in excess of revenues, so long will the ıdget deficits swell the amount of currency or credit outstanding. Henri Chéron's estimate be correct, the French Banking situation ıtil 1930 will improve only to the extent that the actual savings of ına-fide investors can absorb government obligations.

The Italian[81] monetary situation is, in most respects, a reprint smaller type of the financial condition of France. The dominant rce is the Treasury. On March 31, 1920, advances to the State nstituted over 50% of the assets of the Bank of Italy. For the ree Banks of Issue taken together the returns for January, 1920, mpared with the position in January, 1914, show that:

(1) Gold reserve increased 360,000,000 lire.
(2) Note circulation expanded 13,350,000,000 lire.
(3) Deposit obligations rose 2,058,000,000 lire.
(4) The reserve ratio declined from 63.9% to 11.2%.

ıe advances of the Bank of Italy[82] increased from 126,000,000 lire 1914 to 1,126,000,000 lire on October 31, 1919.[83]

How impossible it is for a country to avoid inflation where the easury continuously spends more than it raises by taxation is perctly illustrated by Italy's experience during 1920. With the aim reducing advances to the State, and of contracting note-circulation, aly raised a large voluntary loan. Instead of being able to limit

[80] Figures for the Credit Lyonnais, Comptoir d'Escompte, Société Génée et Credit Industriel et Commercial, as the chief credit institutions, have en grouped together by a well-known economist, Edmond Thery, and set rth in the following table (in millions of francs):

| | June 21 | June 20 | June 14 |
|---|---|---|---|
| Capital and Reserves | 1,451 | 1,375 | 1,419 |
| Cash in hand and at banks | 1,221 | 1,246 | 617 |
| Bills and Treasury Bonds | 9,692 | 9,303 | 3,542 |
| Advances | 585 | 850 | 1,081 |
| Current Accounts (debit) | 2,466 | 3,374 | 1,631 |
| Acceptances | 149 | 241 | 147 |
| Deposits at call and current accounts | 12,628 | 13,387 | 5,455 |
| Fixed Deposits | 149 | 241 | 380 |

—Wall Street Journal, December 13, 1921.

Cf. Federal Reserve Bulletin, March, 1922.

[81] *Cf.* Table VII, p. 158.

[82] Advances to the Treasury and Other Advances are not separated until larch 31, 1920. It is probable that the figure for October 31, 1919, represents rgely Government advances.

[83] No returns between October 31, 1919, and March 31, 1920.

further credit expansion during the year, the banking position at the end of 1920 was actually weaker than at the beginning. The anomaly is easy to explain: purchasers paid for their government bonds not with actual savings but with bank borrowings. Whether, in meeting a budget deficit, the public borrows from the banks, in its own name, to pay for a state loan, or in the name of its government by discounting Treasury bills, is immaterial. The outcome is inflation.

During the first half of 1920 the nominal value of the consolidated and redeemable State stocks has increased from 35 to 52 milliards, or nearly 50%. All this means that time will be required for the absorption and assimilation of the 20 milliards of the last loan, seeing that the issue of Treasury bonds of all kinds, far from ceasing, is stimulated. Meanwhile, the bank note circulation issued for trade purposes acts by way of support, if not of mainstay, of finance, a function which will be continued during the period requisite for the *accumulation of further savings destined to extinguish private debts incurred in order to take up State loans.* It was an error to believe and to make others believe that the note circulation would be appreciably and suddenly reduced. Those who do so forget that, precisely owing to the loan, the circulation by the banks would be increased and that the capital otherwise available for commercial and industrial purposes would be reduced. As the loan not yet subscribed comes gradually into the hands of those who have accumulated savings, so will the note circulation created by credit transactions related thereto, be gradually reduced and will be followed by the reduction and cessation of the needs which produced it.[84]

To what extent the banking position deteriorated during 1920 is shown by the comparative returns for the note-issuing banks in January and December:

(1) Gold reserve increased 56,000,000 lire.
(2) Deposit obligations rose 183,000,000 lire.
(3) Note circulation expanded 4,097,000,000 lire.
(4) The reserve ratio declined to 9.3%.

At the Bank of Italy, advances increased from 1,126,000,000 lire to 10,930,000,000 lire; of the latter figure, 8,636,000,000 lire represented advances to the Treasury.

Aided by a reduction in budget deficits and by the trade depression, Italy also has been able to limit further credit and currency expansion during 1921. In the first half of the year:

(1) Gold reserve decreased 88,000,000 lire.
(2) Note circulation fell 1,572,000,000 lire.
(3) Deposits declined 193,000,000 lire.
(4) The reserve ratio rose to 9.7%.

[84] Bonaldo Stringher, Economista d'Italia, September 28, October 5, 1920 (translated in Economic Review, vol. ii, p. 527).

Meanwhile the Treasury succeeded in reducing its loans at the Bank of Italy by 2,229,000,000 lire.[85] In this energetic action there is evidence that Italy has found it possible at least to limit further expansion and perhaps even to begin a policy of very gradual deflation.

Whereas Great Britain has been able actually to carry out a policy of deflation; whereas France and Italy have, at least, reached the highest point of note-circulation, Germany[86] is inflating her currency at an ever-accelerating pace. Each year the demands of the Treasury on the Reichsbank become heavier; each year the Central Institution must manufacture more credit and more currency.

In the four and a half years of war, from June 30, 1914, to December 31, 1918:

(1) Gold reserve increased 856,000,000 marks.

(2) Paper money rose 5,189,000,000 marks.

(3) Commercial Bills, Checks, Treasury Bills, increased 26,248,000,000 marks.

(4) Bank notes in circulation increased 19,585,000,000 marks.

(5) Deposits were higher by 12,376,000,000 marks.

The inflation during the war is as nothing compared with the expansion of credit and currency in the three years after the Armistice. From December 31, 1918, to December 31, 1919:

(1) Gold reserve decreased 1,173,000,000 marks.

(2) Paper money rose 6,657,000,000 marks, against an average increase per year of 1,200,000,000 marks in the 1914-1918 period.

(3) Commercial bills, checks, treasury bills were higher by 14,329,000,000 marks, whereas the yearly pre-armistice increase was 5,000,000,000 marks.

(4) Bank Notes increased 13,510,000,000 marks, against 4,400,000,000 marks in each war year.

(5) Deposits increased 3,792,000,000 marks, against 2,780,000,000 marks per year during the war.

To what extent the Reichsbank manufactured credit on government account during 1919 is evident from the increase of 14,329,000,000 marks in "Bills Discounted" and the corresponding rise in note circulation of 13,510,000,000 marks. Even this expansion is insignificant

[85] As of December 31, 1921.
[86] *Cf.* Table VIII, p. 159.

when viewed in the light of the Reichsbank Returns for the end of 1920. Between December 31, 1919, and December 31, 1920:

(1) Gold reserve increased 3,000,000 marks.
(2) Paper money rose 11,490,000,000 marks.
(3) Bills discounted increased 18,889,000,000 marks.
(4) Bank notes in circulation were higher by 33,108,000,000 marks.
(5) Deposits rose 5,245,000,000 marks.

The net outcome of this ever more rapidly growing inflation is that the Reichsbank has lost its control over the money market. It has become the printing press of the government.

It cannot be denied that the Reichsbank has to a certain extent lost its predominance in the money market, a fact which is mainly due to the continuous pressure of superfluous money in trade and to the large deposits and balances of the other banks. Without this pressure, trade would have to have obtained loans from the Reichsbank, or other loan banks, by means of credit, and at a very dear rate. At the moment, the Reichsbank has no effective and seriously discussable means of protecting itself against this at its disposal. The suggestion that the Reichsbank should simply decline to discount Treasury Bills has been ignored hitherto, owing to the idea that prevails that thereby the credit of the country and of the bank itself would be seriously affected. It is hardly likely that the Treasury would send its Bills direct to the money market were the Bank to refuse to discount them, and in any case, the result would not be very favourable.[87]

What matters is not where the Treasury sends its bills to be discounted; the important point is that the state is compelled to borrow. Were the Treasury to take its bills direct to the money market, the method of credit expansion would be different, the result, however, would remain the same. Where before the Reichsbank had lent the government 18,889,000,000 marks directly on the Treasury's notes, the banks would now lend the purchasers of Treasury Bills the money to pay for them. In either case the result is inflation.

The more bills the Treasury discounts, the more notes it takes from the bank; the more currency it receives, the more it pays out and the higher prices go; the more prices rise, the greater will be state expenditures and budget deficits; the larger the debit account in the Treasury, the greater the amount of bills which the government will need to discount. No more vivid picture of this degenerating

[87] Deutsche Allgemeine Zeitung, January 4, 1921.

sequence could be drawn than the Reichsbank's comparative statements of December 31, 1921. In the space of a single year:

(1) Gold reserve decreased 97,000,000 marks.
(2) Paper money decreased 16,454,000,000 marks.[88]
(3) Bills discounted increased 72,658,000,000 marks.
(4) Notes in circulation increased 44,833,000,000 marks.
(5) Deposits increased 10,578,000,000 marks.

Where the budget deficits increase in almost geometric progression, and where the Treasury is as utterly dependent on the Reichsbank as these returns indicate, it is useless for the Central Banking Institution to attempt any other function than that of being the note-issuing press of the government.

Zusammenfassend wird man von diesem Teil der Erörtungen sagen dürfen, dass sie ein Ergebnis, auf Grund dessen bereits heute eine aktive Diskontpolitik der Reichsbank zu fordern wäre, nicht gezeitigt haben. Der Wunsch, die Führung der Reichsbank am Geldmarkt wiederherzustellen wird wohl erst erfüllbar sein, wenn sie von ihrer Arbeit im Dienste ungesunder Reichsfinanzen wieder einmal entlastet werden kann.[89]

## Settlement of International Debts.

If mere change were a sign of progress, the Reparations problem would long ago have been solved. Not only has the question concerning the manner and means of payment passed through several stages, but the "final" figure for the total amount of the indemnity is ever being "revised." Under the terms of the Treaty,[90] the amount of the reparations was left indeterminate. The Treaty merely provided for the payment of $5,000,000,000 before May 1, 1921; from this Germany might deduct the cost of the armies of occupation and such food and raw materials as the Allies should deem essential to enable Germany to meet her obligations. Payment of $10,000,000,000 and any balance of the first $5,000,000,000 was to be made before May 1, 1921, in bonds bearing interest at 2½% to 1925 and at 5% and 1% amortization thereafter.

Although the Peace Treaty was signed on June 28, 1919, it was not till almost a year later that the amount of the indemnity again came up for formal discussion. The Hythe conference on May 16,

[88] This extraordinary and apparently paradoxical decrease is due to the ruling in 1921 that the bank could count as cover cash or treasury bills. This permitted the Reichsbank to substitute treasury bills for "Paper Money" which were Darlehenskassenscheine und Reichskassenscheine. (Journal of Commerce, January 31, 1922.)

[89] Enquête der Sozialisierungskommission, Frankfurter Zeitung, August 28, 1921.

[90] *Vide* appendix, p. 149.

1920, brought forth the tentative proposal of 120,000,000,000 gold marks in connection with parallel liquidation of the inter-Allied war debt contingent on Germany's payments. Since the United States did not participate in this conference, such an agreement was unworkable.

At the conference at Boulogne on June 21-22, 1920, the French proposed 269,000,000,000 gold marks payable in forty-two annual instalments. On July 2, 1920, at a meeting of the premiers in Brussels, the discussion was based on a figure of 120,000,000,000 gold marks. By January, 1921, as the Paris conference provided, the Allied premiers finally reached an agreement. They approved reparations figures amounting to 226,000,000,000 gold marks, payable in forty-two years, in installments of 2,000,000,000 gold marks annually for the first two years, 3,000,000,000 gold marks for the next three years, 4,000,000,000 gold marks for the three following years, 5,000,000,000 gold marks for 1929, 1930, 1931, and 6,000,000,000 gold marks from 1932 to 1962. In addition, Germany was to pay an annual tax of 12% on her exports.

Since these figures were unjustifiably high from an economic standpoint, the Germans submitted counter proposals in London on March 1, 1921. They offered to pay a total of 50,000,000,000 gold marks, from which they deducted 20,000,000,000 gold marks for property surrendered, leaving a balance due to the Allies of 30,000,000,000 gold marks. Indignant at such a low figure, the Allies presented an ultimatum to Germany on May 5th. Germany, threatened with an invasion of the Ruhr, accepted the terms. The final proposals provided for the issue of three series of bonds which were respectively a first, a second and a third lien.[91] The total amount of the Reparations was 132,000,000,000 gold marks. Six per cent of this sum payable annually, would be 7,920,000,000 gold marks. Of this Germany is to pay a fixed amount of 2,000,000,000 gold marks per year, and in addition a variable sum equal to 26% of German exports. Whereas, under the provisions of the Treaty, Germany was debited with interest at 5% on the whole debt, under the terms fixed in London the unissued bonds, Series C, bear no interest. To supervise the collection of the

[91] The first bonds, series A, amounted to 12,000 million gold marks, to be delivered by July 1, 1921, bearing interest at the rate of 5 per cent per annum and accumulating 1 per cent as a sinking fund. The second, or series B bonds, amounted to 38,000 million gold marks, to be delivered by November 1, 1921. The series C bonds, estimated at 82,000 million gold marks, were to be delivered by November 1, 1921, with the important reservation that the Reparations Commission was to attach the coupons and issue these bonds only as and when it was satisfied that the payments to be made under the agreement were adequate to provide for interest and sinking fund. The Reparations Commission was to decide from time to time as to the capacity of Germany to pay and issue additional bonds accordingly.

(Lloyd George Statement to House of Commons, May 5, 1921.)

% export tax a Committee on Guarantees,[92] operating under the :parations Commission, will sit in Berlin.

Despite the unending rumors concerning the revision of this final ure, political conditions, at least in France, demand that the 132,-0,000,000 gold marks agreed upon in London stand. Since 60% this total, the 82,000,000,000 gold marks represented by Series C, contingent on Germany's capacity to pay, or rather on the Allies' llingness to receive, it would appear that as soon as public opinion s been adequately educated by demonstration—or experience—the ure will be reduced in name as well as in fact.

Ever-changing as has been the total of the claim which the Allies ve wished to exact from Germany, it has been no more uncertain :n the form in which the Associated Powers have decided to take rment. Originally the Commission stipulated that the 1,000,000,000 d marks representing the first payment be made in dollars. When, vever, the conversion into New York exchange of the several cur- cies accumulated by Germany caused a marked depreciation in the ropean exchanges, the Reparations Commission decided, on June 1921, that remittance might be made in European currencies.[93]

In view of the great difficulty Germany experienced in finding suf- ent foreign bills in European currencies to pay the successive in- lments of the Reparations bill,[94] Louis Loucheur and Walther

[92] Its powers will be restricted to supervision and control and the receipt payment, but will not authorize interference in German internal adminis- :ion. The receipts from taxes and materials in kind will be pledged for the ment of interest and amortization on the bonds issued. Like the German nter-proposals the London proposals provide for the pledging of other Ger- n revenues as security for payment of interest on the bonds.

[93] So as to avoid disturbance of the exchange market the Commission on parations has given permission that for the month of June and as a trial, ments by Germany should no longer be made in dollars, but in European rencies.—Associated Press, June 28, 1921.

"This decision has been made possible through the action of certain allied vers, which have consented to assume the risks of exchange with respect to tain different currencies and for definite amounts."—Decision of the Repara- is Commission, June 28, 1921.

[94] Das Reichsfinanzministerium teilt mit, dass die letzten Zahlungen für Einlösung der auf Grund des Londoner Ultimatums ausgegebenen zwan- Wechsel nunmehr überwiesen sind, so dass am 31. August alle Wechsel gelöst sind und die Milliarde Goldmark pünktlich gezahlt ist.

Hier heisst's mit Goethe: "Du sprichst ein grosses Wort gelassen aus." Menge hört heute so viel von Milliarden und hat die vor fünfzig Jah- als Phänomen bestaunte Kriegsentschädigung von 4 Milliarden Mark völlig vergessen, dass unsere nunmehrige erste Milliarde kaum noch ge- digt wird. Darum wäre es notwendig, dass die Reichsorgane nicht in weigen und Bescheidenheit vergehen, sondern dem Auslande, aber vor m auch der in den Tag hineinlebenden eigenen Bevölkerung auseinander- en und einhämmern, welche ungeheure Geldbewegung sich schon mit der en Goldmilliarde verband (in unserer Papierwährung mindestens 16 Mil- len), welche staubaufwirbelnden Marktverschiebungen, Devisen-, Kauf- Sicherungs-Operationen sie notwendig machte, welche finanziellen Lasten Unkosten der Zahlungsvorgang dem Reiche und damit der Allgemein- auferlegt hat, welche bedeutenden technischen Anstrengungen und Vor-

Rathenau concluded an agreement on October 6, 1921, at Wiesbaden for payments in kind.[95]

When Germany notified the Allies on December 14 that she would be unable to meet the January 15 payment of 500,000,000 gold marks and the February 18 instalment of 275,000,000, the Reparations Commission permitted Germany to remit 31,000,000 gold marks every 10 days until it had investigated conditions in Germany. Because of the difficult political situation the reparations problem has only reached a point where the increasing difficulty Germany experiences in remitting, and the Allies in receiving, is compelling public opinion to accept the idea of a reduction.

All too brief must be the account of the progress the various countries have thus far made in the settlement of international debts. The unfunded balance which the United States has accumulated against Europe in the post-Armistice period still stands in substantially the same unsecured form as at the time America granted the credits. The first and only step towards a solution of the problem is the information, published by the Federal Reserve Baord, concerning the amount and character of these obligations. On October 1, 1921, the net claims of the United States against Europe[96] totaled $2,708,000,00. This figure, while it covers all items that are usually included in reckoning international balances, omits extraordinary factors, such as settlements of cancelled war contracts of approximately $500,000,000, and other

sichtsmassregeln und wie viele Eisenbahnwaggons der Transport von vielleicht 500 Tonnen Lombardsilbers und 25 bis 30 Tonnen Zahlungsgoldes erforderte und—wie dennoch, trotz viermonatigen Aufgebots aller Kräfte, die Milliarde nur dadurch erfüllt werden konnte, das man mit einem ansehnlichen Teilbetrage die Zukunft vorbelastete.—Frankfurter Zeitung, September 1, 1921. The Reichsbank effected the settlement by paying 60 million marks in silver, 83 million marks in gold, 500-600 million marks in bills of exchange and the remainder in credits negotiated in Holland, Denmark, Sweden, Switzerland, the United States and England.

[95] Germany engages to deliver to France upon her demand all machinery and materials which would be compatible with the possibilities of production in Germany and subject to her limitations as to supplies of raw materials. Such deliveries will be in accord with the requirements necessary for Germany to maintain her social and economic life. This agreement shall date from October 1, 1921.

In any case the present contract excludes the products which it is specified Germany must turn over to the Allies in Annexes 3, 5, and 6, Part VIII of the Treaty of Versailles (referring to deliveries of ships, coal and dyes). The cumulative value of the payments in kind which Germany will supply France in execution of Annexes 3, 5, and 6, as well as deliveries Germany makes to France under the present contract, will not exceed 7,000,000,000 gold marks from October 1, 1921, to May 1, 1926.

It is expressly stipulated that all deliveries shall be devoted to the reconstruction of devastated regions in Northern France. (Official Text of the Wiesbaden agreement.)

[96] Statement showing the International balance of the United States on

claims. All in all, the floating debt of Europe to the United s close to $4,000,000,000.

›t so much the actual amount but rather the nature of this weighs on the exchanges.

: question as to how this great international balance has been . or "carried" is one which has been the subject of frequent discus- . The idea that it could be largely carried in the form of open ; on the books of American merchants has been criticised by some, e is much evidence to show that a very large proportion of it has been so carried. In other cases the indebtedness has been paid gn buyers of American goods, but in their own currency, as the f which American establishments have found themselves the pro- of large balances on the books of foreign banks which they could g home without very severe loss due to the depreciation in ex- and which they, therefore, in many cases preferred to "carry" :h time as the sums due could be realized upon a basis more cor- ing to the original parity of the local unit of currency in Amer- ney.[97]

1, 1921. Source: Federal Reserve Bulletin, November, 1921.

(In millions of dollars)

| s | | | | |
|---|---|---|---|---|
| Jnited States, Creditor | 1919 | 1920 | 1921 (9 months) | Total Jan. 1, 1919, to Oct. 1, 1921 |
| ›f exports of merchandise........ | 4,016 | 2,949 | 1,679 | 8,644 |
| ›rts of gold and silver.......... | 441 | .... | .... | .... |
| ›rts of Federal Reserve notes.... | 91 | 103 | .... | 194 |
| :est payments receivable (private) | 60 | 125 | 150 | 335 |
| ın freight payments receivable.. | 220 | 140 | 50 | 410 |
| .1 credit items.................. | 4,828 | 3,317 | 1,879 | 9,538 |
| Jnited States, Debtor | | | | |
| ›rts of gold and silver........... | .... | 70 | 559 | 138 |
| ports of United States paper :ncy .......................... | .... | .... | 100 | 100 |
| ernational payments of United :rnment ...................... | 2,375 | 305 | * | 2,680 |
| ate investment of American capi- .broad.......................... | **300 | **235 | 250 | 785 |
| ı securities resold to United States | 150 | 125 | 40 | 315 |
| nts' remittances and relief....... | **600 | **700 | 300 | 1,600 |
| expenditures .................. | **50 | **150 | 125 | 325 |
| l debit items.................... | 3,475 | 1,585 | 1,374 | 5,993 |
| :ions to unfunded credit balance of Jnited States.................... | 1,353 | 1,732 | 505 | 3,590 |
| ınce on open account owed by :d States, December 31, 1918.... | .... | .... | .... | 882 |
| nded credit balance of the United s, October 1, 1921***........... | .... | .... | .... | 2,708 |

*Definite figures not available.

**Estimate of John H. Williams, in Review of Economic Statistics Supplement, June, 1921.

***Subject to the modifications noted in the accompanying text.

leral Reserve Bulletin, November, 1921.

With so great an amount of floating obligation in existence, there has always been a tendency whenever exchange rates recovered ever so slightly to "dump" some of these balances on the market.[98] The amount so far converted back into dollars is, however, exceedingly small.[99]

In the matter of foreign-held currencies reliable information is unavailable. The "best guesses" venture an estimate for Germany of 25,000,000,000 to 50,000,000,000 marks.[100] "What such speculative purchases amount to, it would be difficult to say, but in any event, such purchases have been an important element in the financing of the trade balance running in favor of the United States."[101]

Despite the unending discussion[102] on the settlement of the inter-Allied debt tangle, the various countries have made little headway in reaching an agreement. The United States, on whom the fulcrum of the balance rests, has finally, after wearing delays, attained the preliminary step. The Debt Funding Bill has passed.[103] It provides for a commission of five empowered to "refund the obligations of foreign governments to the United States." The Act gives the commission authority to extend the payment of the principal, the interest, or both "*provided:* that nothing contained in this Act shall be construed to authorize or empower the commission to extend the time of maturity of any such bonds or other obligations due the United States of America by any foreign government beyond June 15, 1947, or to fix the rate of interest at less than 4½% per annum."[104] The third section embodies the theory held by Senators and Congressmen "That this Act shall *not* be construed to authorize the exchange of bonds or other obligation of any foreign government for those of any other foreign government, or cancellation of any part of such indebtedness except through payment thereof." When the commission has been appointed, when it has negotiated with each of the foreign countries in turn, when it has taken long-term obligations for the promissory notes now held by the United States Treasury—we will be just where we were before. ". . . . some new pieces of paper bearing a slightly different wording will be in the hands of the Treasury. It will be a technical or 'book' transaction without result unless foreign countries take a different point of view and seek to provide in their budgets for a settlement."[105] Only one country, Great Britain, has given even so much as an indication of her readiness to pay, and then only by way

[98] Journal of Commerce, November 14, 1921.
[99] *Ibid.*, February 6, 1922.
[100] J. M. Keynes, Frankfurter Zeitung, April 2, 1921.
[101] Federal Reserve Bulletin, February, 1922.
[102] A full history of this discussion is given in Friedman, *op. cit.*, pp. 543-577.
[103] For the text of the bill, *vide* Appendix, p. 151.
[104] Public—No. 139—67th Congress (H. R. 8762).
[105] Journal of Commerce, December 13, 1921.

forecast of next year's budget. Meanwhile, she herself has a cur-ıt deficit likely to run to $200,000,000.

The United States, on the other hand, has thus far not shown y great eagerness to receive payment. Despite its pronouncements ainst cancellation, Congress is, at present, engaged in passing a 'iff bill which will have the effect of categorically forbidding the lies to pay.

TRADE BALANCE.

As in other respects so too in righting her trade balance[106] Great tain has made substantial progress during the three post-war years. ıereas the ratio of imports to exports rose from 121.1% in 1913 to '.2% in 1918, it declined to 169.5% in 1919 and to 125.6% in '0. Particularly noticeable was this tendency back to normal in latter part of the year. While the imports to exports ratio stood 140% for January, 157% for February and 135% for March, it ched 119% in the May-December period. Despite the coal strike l the consequent drop of 30% in the value of exports during April, y and June, the complete returns for the year ended December 31, '1, show a debit merchandise balance of but 276,000,000 pounds. t only is this fully offset by invisible credit items but there is prob-y a small credit balance.

Though the imports to exports ratio has approached the pre-war ıre the equilibrium in 1921 resulted from a decrease in imports her than from an increase in exports. A résumé of the British 'eign trade shows that the value of goods sold abroad in 1921, if ısidered in terms of tonnage, were not more than 30% to 40% of pre-war volume though approximately 80% of the exports of '0.[107] To consider trade in terms of volume or weight only is as leading, however, as to take into account the money value alone. ore the war the greatest part of British exports consisted of coal, ι and steel. To-day, on the other hand, the more highly manufac-:d steel products form the larger proportion. By converting 1921 ırns into terms of 1913 values the Board of Trade arrives at a timate basis of comparison. For the first nine months of 1921 analysis shows that the actual volume has decreased approximately %. Inevitably the largest decline is in the trade with the continent. ced to a lower standard of living, the people in Russia and the ıtral Empires especially, who before the war took over 20% of tish exports, now import only 2%. Great Britain, dependent on interchange of goods for her very livelihood, suffers severely from slump in trade; yet it is remarkable that, in spite of the coal strike, merchandise balance should have been adverse only by an amount ich she could easily cover by invisible items.

[106] *Vide* Table IX, p. 160.

[107] Federal Reserve Bulletin, February, 1922.

Though it took France longer to balance her exports and imports,[108] the improvement in French foreign trade continued long after Great Britain began to experience the world depression. It appears remarkable that, despite the destruction in the principal manufacturing areas, the returns for 1921 should show a merchandise balance of exports of 400,000,000 francs. Against a debit on trade account of 24,000,000,000 francs in 1919 and 13,000,000,000 francs in 1920 France has raised her exports, to a point 1,900,000,000 francs above the 1913 figure. Whereas the normal peace year showed an excess of merchandise imports of francs 1,500,000,000 which France covered by 2,000,000,000 francs in return on investments, during 1921 French trade actually registered an excess of exports of 400,000,000 francs. In part this surprisingly good situation is the result of a "lag" in exports.[109] Stocked with goods at the beginning of 1921, France continued to make sales abroad in only slightly diminished volume at the same time that she was able to reduce her purchases materially. In fact, the big change in trade balance which occurred in January, 1921, was wholly due to a collapse in imports from 2,948,257,000 francs in December to 1,982,468,000 in January. The group of commodities which shows the greatest percentage decrease is that of manufactured goods, which includes luxuries. This evidences a very desirable curtailment in consumption. Less welcome is the decrease in imports of raw materials since this connotes a corresponding fall in exports when manufacturers have used up the present stock of unfinished goods. On the other hand, the 27% reduction in imports of foodstuffs testifies to the genuine improvement in the agricultural situation.

Although Italy has not found it possible to equate exports to imports,[110] she is able, each year, to show a progressive reduction in her adverse trade balance. While during 1919 she imported an amount of goods valued at three times the sum of her exports, her unfavorable balance on trade account during 1920 was 8 billion lire and for 1921, according to estimates, it will be only 4 billion.[111] Taking into account invisible export items such as tourist expenditures and emigrants remittances the net adverse balance is reduced to between one and two billion lire.[112] Compared with 1920 the physical volume of trade in 1921 shows a 4% decrease in imports and a 12% decline in exports.[113]

[108] *Vide* Table X, p. 161.

[109] Bass & Moulton: *op. cit.*, p. 32.

[110] *Vide* Table XI, p. 162.

[111] Italian foreign trade figures are given in terms of values of 1920. Consequently the figures representing an excess of imports over exports in 1921 exceed the unfavorable balance to the extent that the decrease in prices, January-June, 1921, affected the values of the various imports and exports. (Federal Reserve Bulletin, January, 1922.)

[112] Neue Züricher Zeitung, May 4, 1921.

[113] Federal Reserve Bulletin, January, 1922.

Taking into account the trade depression this decline warrants an optimistic rather than a gloomy outlook for Italian foreign trade.

Since the German delegates to the International Financial Conference in Brussels amazed the whole world by making the remarkable assertion that Germany enjoyed a favorable balance of trade the Statistical Bureau in Berlin, upon close examination, concluded that in 1919 imports were fully 300% of exports and that for 1920 the adverse balance was no less than 30 billion marks.[114] During 1921, however, Germany made good progress in equating exports to imports. According to estimates her debit account for the past year will total only between 10 and 15 billion marks.[115]

In contrast to the commercial conditions in the allied countries, the volume of German trade has shown an increase during 1921. Exports were approximately 4% higher,[116] whereas imports were greater by 35%.

In part the result of the normal post-war readjustment in commercial relations, the growth in trade operations in Germany is, however, mostly due to the unhealthy undervaluation of the mark. When marks first enjoyed a higher purchasing power in Germany than abroad exports were stimulated to such a point that Germany was stripped of goods of every kind. When, however, manufacturers found that with every fresh fall in the mark they must replenish their stocks at foreign prices which reflected the full extent of the depreciation of the mark they imported goods into Germany as feverishly as the exporters sent them out. Thus, every collapse in mark exchange not only incites the export industries to unnatural heights of activity but also swells imports to abnormal figures. True, the increased trade activity only reflects the transitional changes incidental to an adjustment of German prices to world values.[117] But the proces is extremely painful to Germany as well as to the rest of the world and by its prolongation retards the return to healthy stable commercial conditions.

[114] Report of the Statistical Bureau, Deutsche Allgemeine Zeitung, August 2, 1921.

[115] Consular reports to Department of Commerce, Journal of Commerce, November 18, 1921.

[116] Based on tonnage figures for May-November, Wall Street Journal, Berlin Correspondence. January 12, February 7, 1922.

[117] *Cf.* F. W. Taussig vs. F. Bender, New York Evening Post, August 27, 31, 1921.

## CHAPTER VI.

### CONCLUSION.

THE study of the foreign exchanges brings out the nature of the forces which produce fluctuations in the exchange market, the inadequacy of the plans which have been proposed to solve the problem, and the requisites for a stabilization of the foreign exchanges.

The factors which cause disturbances in the course of the foreign rates are the influences which, directly or indirectly, determine the trade balance and the elements which bear on the financial situation of the several countries. Not only those transactions enter into the settlement of international accounts which arise from current indebtedness but also those payments which result from past obligations. Where a country has financed an excess of imports by borrowing abroad in the form of short-term loans, this floating debt constitutes a potential supply of bills which is a constant menace to the stability of its exchange. When rates have been built up by careful manipulation, or when, in response to better economic conditions, the exchanges have risen of their own accord, the unfunded claims, remaining as a legacy from the war years and the post-Armistice period, are offered on the market and depress the rate. Or, when in consequence of some unfavorable event, such as the decision of the Supreme Council on the partition of Upper Silesia, the rate of a country shows a tendency to weaken the large amount of floating bills in the possession of foreigners is likely to be thrown upon the market. In this connection it is immaterial whether the indebtedness of the particular country be in the form of bills of exchange or of currency. When holders see a chance for gain as a consequence of rising quotations, or when, in the opposite case, they fear a heavy loss, they will hasten to convert into their home currency.

In so far as a country cannot pay for its current imports by exports or long-term loans, its unfavorable trade balance produces fluctuations in exchange when the excess supply of bills is intermittently offered on the market. The oscillations resulting from a net present debit account are not likely to be as wide as the movements caused by a carry-over of floating claims from past adverse balances. For, where the offering of exchange representing a current excess of imports comes on the market from time to time as the bills mature, the obligations inherited from previous periods tend to be pressed for sale in large amounts either for the purpose of realizing a profit or in order to avoid a waste in assets.

Since the war, the settlements arising from international capital transactions are fully as important in determining the fluctuations in the exchange market as the payments necessitated by the movements of trade. In Germany the fear of a great increase in taxation caused a "flight of capital" which resulted in violent movements of the domestic and even of foreign currencies. The liabilities of Germany in connection with the reparations plan produce disturbances in the exchange market which at times overshadow all other influences. Not only the actual settlements of foreign accounts but also those forces which bear upon the probable balance and distribution of international indebtedness produce fluctuations in the quotations of foreign bills. Grave social disturbances which may seriously impair the productive capacity and therefore the export power of a country tend to depress its exchange; serious political complications which threaten to cause a state to default on its international obligations produce irregular oscillations in the course of its exchange in foreign centers. The uncertainty with respect to the settlement of international debts both between ex-enemies and between the allies themselves is an unending source of disturbance in the market for foreign bills, on account of its inevitable effect on the fiscal position of the countries involved and because of its influence on the balance of international obligations. These forces do not result immediately in a supply of bills offered on the market but traders by their activities, translate the effect of the indirect factors into exchange quotations. Although speculation cannot for any great length of time hold the price of bills above or below the level determined by the actual fulfillment of obligations, nevertheless it can and does cause sharp movements in the course of foreign exchange.

Whereas the transactions arising from the settlement of international obligations produce the immediate supply of bills of exchange, the internal value of the currency in each country determines the relative level of its exchange. The fluctuations in the foreign rate during the past three years have to a great extent been the reflection of the attempt on the part of the exchange market to adjust the prices in the various countries. During the war and in the post-Armistice period the several countries expanded their currencies in different degrees. Increase in note and deposit circulation, unless based on the legitimate needs of trade, causes a rise in prices, inflation and depreciation of the monetary unit. To maintain on the one hand, the correct relationship between the prices of commodities in the different countries, and on the other the equilibrium in the values of the goods as amongst themselves involved constant changes in the quotations of foreign bills.

Since the war, the governments in most European countries have been largely responsible for the depreciation of the currencies. The granting of credit based not on immediately exchangeable values but on borrowing by the treasury to meet budget deficits results in inflation and a consequent decline in the purchasing power of money over goods. Consequently any increase in state expenditures which is likely to cause a substantial addition to the demands of the Treasury on the Central note-issuing Institution, involves a new readjustment on the exchange market.

In some countries undue expansion in private borrowings heightens the evil effects of government manufacture of credit, weakens the banking position still further, and is an added element in the depreciation of the currency. Whether the unit of currency be the mark or the franc, the pound or the lira, whether the fluctuations represent a major swing or a minor oscillation the factors which influence the course of the exchange market are the state of the currency as determined by government finances and the banking position; the influences, immediate as well as indirect, of international indebtedness, and the balance of trade.

Any plan which fails to correct the adverse forces which cause fluctuations in the exchanges must fail. The problem of stabilizing the foreign rates is too intimately related to the practical business life of the world to permit of a ready solution by extravagantly expensive plans or by vaguely theoretical schemes; the movements in the course of the foreign rates are too universal, too far-reaching in their effects to be righted by partial remedies.

A reintroduction of the pegging device to eliminate the oscillations in the quotations for foreign bills involves an enormous expense. In the face of the already existing budget deficits in practically all European countries such artificial stabilization could be effected only at the cost of additional government borrowing and consequent inflation. Furthermore, the scheme is undesirable because it would mean the re-imposition of war-time restrictions on commerce and the inevitable friction and delays caused thereby. More important even than either the prohibitive expense or the effects of fettering commerce anew is the fact that stabilization above the normal level aggravates the evil it aims to cure. For to hold the exchanges artificially out of adjustment with the relative price level would be to offer an immense premium on imports; whereas what is really needed to correct the situation is a stimulation of exports. The plan for stabilizing the several exchanges at their present quotations rather than on the basis of the old par is open to the same objections as the scheme for pegging the rates. For though the price of bills to-day may be a true reflection of their present value as determined by the balance of trade and the state of currency in a given country, there is no assurance that the same quotation will be equally valid some months hence. In fact, past experience shows that if the value of exchange is to be based on underlying conditions, there can be no stabilized rate unless the factors themselves are corrected.

The plan for limiting the movement of commodities in order to regulate the supply of bills is not feasible. It would involve such a system of control over commerce and trade as would exactly balance the debts and claims of the particular country. The consequences of the applications of such elaborate systems of export and import restrictions hardly justify the expectation that they will be of much use in abolishing exchange fluctuations. Restoration of a regime of barter is out of the question because the direct interchange of commodities could never effect those delicate adjustments in international settlements which the complexities of modern trade require. Although some of the smaller central European states have concluded barter agreements they were for such small amounts that they are practically insignificant.

The proposal for establishing fixed or theoretic rates for the value of local currency in terms of a new unit of money for each country is a plan of the gold-exchange standard type. If the plan is to succeed in stabilizing rates it is essential that the country adopting it should have a fairly equal trade balance; for otherwise it would soon be rid of its specie reserve. It is equally important for the operation of the plan that the country in question have a stable currency; for should there be inflation, the rise in prices, unaccompanied by a fall in exchange, would stimulate imports. As the adverse merchandise balance increased the reserve would be exhausted. Since the countries where it is proposed to establish the gold exchange standard have neither an equilibrium in their exports and imports, nor a stable currency, the proposal will not solve their exchange difficulties.

Of the schemes which require international cooperation, the "purchasing power parities" plan is the most attractive. Based on the idea that exchanges depreciate not because of an adverse trade balance but because of a lessening of the purchasing power of a unit of home money over goods, this proposal would abolish fluctuations in the market for foreign bills by stabilizing the internal value of the monetary unit. The scheme necessitates an agreement on the part of all countries to maintain their prices, by expansion or contraction of the currency, at the same respective levels. Though carefully worked out and well conceived, the solution is uncertain in some respects, incomplete in others. It is doubtful whether the regulation of the supply of money has that power of adjustment over its value which the successful operation of this plan implies. Even if the quantity theory worked out in practice, the proposal would be of little assistance in solving the exchange problem of those countries which are most afflicted; for they have long since lost all power of contracting their note and credit issue. The scheme, were it actually possible to apply it in practice, would still have room for wide oscillations, for it would not be possible to counteract a premium on exchange by an issue of currency fast enough to offset the scarcity in the supply of bills. Plans for establishing international banks or currencies based on gold or other forms of tangible or intangible wealth while fascinating in theory are at present both unnecessary and impractical.

The various credit schemes which have been worked out point to partial solutions rather than to complete remedies. Plans for making loans to the European states not secured by specific assets are not likely to materialize; for under present conditions these countries have no assured means of paying either interest or sinking fund. With a view to making the transactions both safe and liquid the Ter Meulen Bond plan has been advocated. The scheme is practical and should at least succeed in giving some aid in the restoration of trade. In the United States the War Finance Corporation and Edge Act Corporations have been suggested as a means of furthering trade and thus solving the exchange problem. In Great Britain, the Overseas Trade Act places government aid at the disposition of British export trade; in Belgium the government has passed similiar legislation. All of these schemes assume that there is a trade to be done and merely place the abnormal risk of a credit spread over a few years on the state or special corporations. Unfortunately in the worst cases there are no goods to trade in; while in the better cases the importer cannot produce adequate security to cover the risk of a fall in the value of his currency measured in sterling and dollars—or even Belgian francs. Far from being able to eliminate the fluctuations the plans themselves are greatly hindered in their successful operation, by the instability in the exchanges.

"The suggestion of a "Stable Exchange Union" as the kernel from which would grow the re-establishment of a universal gold standard offers a solution which must of necessity be very incomplete. At present the "union" could at best consist only of a very limited number of countries. Even within its narrow field the idea would not be likely to work out effectively. For unless a country had an equlibrium in its trade balance with the other states which at that time happened to be members of the "Exchange Union" it would either lose its gold to them, or conversely they would lose theirs. Experience shows that the European countries which could at present belong to the "union" would very probably ship their specie to the United States while their debtors would meet their obligations by sales of exchange. Thus the creation of a "Stable Exchange Union" would not stabilize the exchanges.

Most of the current solutions err because they attempt to cure the disease by treating the symptoms. To eliminate the fluctuations in the exchange market it is essential to correct not the actual position of the exchanges but those conditions which have brought it about. Until the adverse forces which produce disturbances in the course of the several rates are abolished, no permanent stabilization is possible.

One of the most potent causes of exchange fluctuations is the constant change in the internal value of the several currencies. Since the most important reason for the chaotic monetary situation in most European countries to-day is the manufacture of credit on government account the primary condition of the restoration of order in the mechanism of international exchange is the cessation of government borrowing. It is only when the state can meet its expenditures by tax-revenue that the treasury does not need to resort to bank advances. The starting point of all fiscal reform is therefore a re-establishment of budgetary equilibrium. Before they will be able to balance their budgets European states must make drastic reductions in expenditures. Accustomed by the recent war to extravagant appropriations for military purposes, nations are still spending one-fifth of their receipts on armaments. Although the need for cutting down this item is now almost universally recognized, nations are so reluctant to reduce their military expenditures that the imperativeness of this reform cannot be too strongly emphasized. Since debt services represent everywhere the largest outlay, any reduction, however small, means substantial relief. Governments should therefore pay off their obligations as soon as possible. Where they cannot reduce the principal of their debts they should refund them at lower rates. It is also essential that states liquidate at the earliest possible date the departments created to carry on the war and that they confine their activities to the indispensable government functions. So necessary is it for countries to limit their expenses that even productive extra expenditure should be restricted to the most urgent requirements. That expenditure everywhere must be kept within the bounds of existing revenue is evident from the fact that only in a very few countries can receipts be increased to re-establish equilibrium in the budget. Taxation in most European states has reached the point where it impinges not only on the formation of new wealth but even on the maintenance of existing capital. The primary condition of fiscal reform, therefore, is a reduction in expenditure.

The problem of restoring the currency systems in Europe to a stable foundation is not, however, only a question of re-establishing budgetary equilibrium; it is also a question of applying to the banking practice of each country the sound and healthy principles of the normal pre-war times. Since, during the war, the restrictions which caused an increase in the amount of currency to mean a decrease in the sums available for bank reserves were removed, expansion on private as well as on public account might be unlimited. As a result of the rise in prices and the consequent need for larger credits, business men borrowed on the basis of government obligations. To remove this element of inflation it is essential that these loans be liquidated as rapidly as possible and that the securities pass into the hands of bona-fide investors. Equally important is it that business men pay off loans incurred for capital expenditure. During the war the enormous demand for commodities and the rapid rise in prices induced producers to increase their plant capacity. Due to the scarcity of funds in the investment market, resulting from repeated government loans, business men borrowed from their banks for capital purposes. Unless bankers are willing to continue the unsound practise of constant renewals, they must induce their customers to liquidate these loans at the earliest possible date. Only when some persons in the community have a surplus to invest will the government securities and long-term bonds pass from the vaults of the banks into the hands of actual investors. The interest charge is that force which in normal times determines the rate of savings. A final requisite, therefore, for the restoration of a sound monetary situation is the raising of the interest charge to that rate which will correspond to the true scarcity of capital and which will regulate the supply of consumable goods according to the reduced standard of living.

From the analysis of the course of the foreign exchanges it was clear that one of the most important causes of fluctuations in the quotations of bills is the question of international debts. Since the payments of the Reichsbank on reparations account produce wide oscillations in the rates for bills an integral part of any plan for stabilization must involve a method of settlement which will not subject the exchange market to the hectic fluctuations of the past year. Even more disturbing than the government operations in connection with the indemnity is the factor of uncertainty. Unless the course of the exchanges is to suffer from the abrupt and irregular movements resulting from constant "revisions" it is imperative to substitute for the requirements now in force a rational and permanently workable solution. At present the German government cannot meet the sums exacted in the ultimatum except by borrowing; it cannot effect payment except by selling marks. The most practical and therefore the wisest plan would be that the Allies postpone all remittances until Germany has had an opportunity to restore her commercial and financial position and that they then secure for themselves payments over a period of thirty years on the scale on which Germany would have been building up foreign investments.

Except for the fact that the United States has not exacted any payments as yet, the inter-Allied debt situation is similar in all respects to the indemnity question. Consequently the plan for settling the problem of Allied indebtedness to the United States should follow substantially similar lines as the suggestion for meeting the reparations question. A definite postponement would afford the United States an opportunity to adjust her exports and imports gradually, while at the same time it would give European countries a chance to restore their trade and their currency. At the end of this period the Allied countries might pay the United States interest and sinking fund at the rate that they would otherwise be making new investments in other countries. To avoid the sudden and unpredictable fluctuations which the large amount of floating indebtedness overhanging the market produces it is essential that European countries fund their short-term obligations.

The correction of the financial position of the European countries, coupled with a settlement of the international debt problem, would remove many of the most important sources of exchange fluctuations. But as long as a country has an adverse balance of trade it must sell its currency for what it will fetch on the world market. If nations are to avoid the pressure on their exchange of this supply of bills they must equate exports and imports. Because of the great destruction of wealth resulting from the war and the reduced efficiency of labor it is imperative that goods be produced with the least possible expenditure of effort. Therefore it will be to the greatest ultimate advantage of the countries to allow the unobstructed interchange of commodities.

When the European countries have succeeded in stabilizing the internal value of their currencies by balancing their budgets and correcting their banking situation, when they have definitely settled the problem of reparations and interallied indebtedness, and have funded their floating obligations and when they have attained a state of equilibrium in their international trade accounts their exchanges will move within narrow limits. There would still be the possibility, however, that, with no gold-points to hem them in, the rates would be liable to fluctuations from sudden demands due to unexpected causes. To insure the smooth working of that mechanism which pre-war experience had shown to be an efficient preventive of monetary disturbances, European countries should return to the gold standard. As each state succeeds in checking inflation and in balancing its international accounts it would be wise for the United States to deposit a specified amount of gold in the Central Bank as a loan in order to hasten the return to convertibility and stable exchange conditions.

To the extent that the several countries have succeeded in fulfilling these requisites have they approached stabilization. The progress of each state, however, must be judged not by absolute standards, but rather with reference to its own difficulties. Undoubtedly Great Britain has advanced by strides. Though her budget does not balance absolutely, she has, within the last three years, made sufficient progress to warrant the belief that she will soon enjoy a "normal" year; her banks are returning to the sound practises of pre-war days; her exports and imports balance. Financial London will doubtless realize its cherished hope: the pound will return to $4.8666. Less marked is the progress of France. Her budget deficits decrease less rapidly; her monetary situation is more disturbed; although her merchandise exports and imports balance, invisible items tell against her. The franc is at the present time overvalued; it will not, for a number of years at least, return to par. In a similar position is Italy. While she makes good progress in equating tax-revenue to expenditures, her increasing floating debt hinders improvement in her banking position. On the other hand, though her balance of trade on account of goods is against her, invisible items are an offsetting credit. At the present time the lira is probably somewhat over-valued; it is not likely that Italian exchange will return to par. Within the limits of the possible, Germany also has succeeded in bettering her position. Because of the great increase in inflation all comparisons in terms of value are practically useless. Whereas her budget deficit has doubled within the last year, her currency has depreciated approximately 300%. Her merchandise trade balance, on the other hand, shows signs of distinct improvement. Marks are, for the time being, undervalued, but the continuing rise in prices and the uncertainty of the reparations makes any value ephemeral. The crux of the financial and commercial situation in Germany is the indemnity question. In fact, it is impossible to consider the budget, the banking position, or the trade balance without reference to this all-pervading problem.

Unfortunately, countries have made but little progress in solving those questions which require international co-operation. In the matter of the indemnity the Allies have set a definite though impossible figure; Germany has sent notices of inability to pay. In the question of inter-Allied debts the commission of five appointed by the President has within the last few days held its preliminary meeting. Handicapped by provisions prohibiting cancellation in any amount or form, and forbidding substitution of any kind, the commission will be forced to let Europe "stew in her own juice." Beset with difficulties on all sides, within their frontiers and especially in their relations with other states, countries are inclined to take a pessimistic view of the future. Looking back over the developments of the last century, there is, however, no cause for pessimism. The Napoleonic Wars left the currency situation almost as chaotic, international trade as unbalanced, the exchanges as disturbed. Yet within less than ten years Great Britain resumed specie payments, her exchange returned to par.

From this study of the foreign exchange situation certain conclusions stand out clearly. There is no universal and readily-applicable solution for the exchange problem. The fluctuations in the market for foreign bills cannot be eliminated by monetary or currency measures alone. Permanent stabilization connotes the correction of those conditions which have brought about the disturbances in the course of the exchanges.

But just as the causes of the movements of the foreign rates are universal in scope, so the requisites for stabilization must be universal in character. Only to a limited extent can countries remedy, by their individual and unaided efforts, the evils of the exchange situation. They are confronted at every turn with questions requiring international adjustment. Unless countries wish to dabble in their economic and exchange problems by the hit-or-miss method of trial and error, unless they actually desire to delay for a long time to come the return to stable monetary conditions, they must settle their international problems in a definite and workable manner.

Their *leitmotiv* must be moderation. Creditors cannot expect to *exact* every dollar of their debts—especially when they are at the same ne intent on passing tariff bills so excellently worded that they will )t allow a single penny in interest or sinking fund to enter the coun- y. In this connection Great Britain's experience after the Napeolonic 'ars is instructive. England did not levy a large indemnity; of her ans to Austria she collected only eleven per cent.

A successful plan for stabilizing the foreign exchanges involves e elimination of those elements which cause fluctuations in the ex- ange market; it implies international co-operation and that degree moderation which past experience has shown to be of paramount portance for the restoration of the normal mechanism of exchange.

# APPENDIX

## TREATY OF PEACE

## SECTION F.

### GENERAL PROVISIONS.

ARTICLE 231.

The Allied and associated Governments affirm and Germany accepts the responsibility of Germany and her Allies for causing all the loss and damage to which the Allied and Associated Governments and their nationals have been subjected as a consequence of the war imposed upon them by the aggression of Germany and her Allies.

ARTICLE 232.

The Allied and Associated Governments recognize that the resources of Germany are not adequate, after taking into account permanent diminutions of such resources which will result from other provisions of the present Treaty, to make complete reparation for all such loss and damage.

ARTICLE 233.

The findings of the Commission as to the amount of damage defined as above shall be concluded and notified to the German Government on or before May 1, 1921, as representing the extent of that Government's obligations.

The Commission shall concurrently draw up a schedule of payments prescribing the time and manner for securing and discharging the entire obligation within a period of *thirty years* from May 1, 1921. If, however, within the period mentioned, Germany fails to discharge her obligations, any balance remaining unpaid may, within the discretion of the Commission, be postponed for settlement in subsequent years, or may be handled otherwise in such manner as the Allied and Associated Governments, acting in accordance with the procedure laid down in this part of the present Treaty, shall determine.

ARTICLE 234.

The Reparations Commission shall after May 1, 1921, from time to time consider the resources and capacity of Germany, and after giving her representatives a just opportunity to be heard, shall have discretion *to extend* the date, and to modify the form af payments.

## Article 236.

Germany further agrees to the direct application of her economic resources to reparation as specified in Annexes iii, iv, v, vi, relating respectively to merchant shipping, to physical restoration, to coal and derivatives of coal, and to dyestuffs and other chemical products; provided always that the value of the property transferred and any services rendered by her under these Annexes, assessed in the manner therein prescribed, shall be credited to her towards liquidation of her obligations under the above Articles.

## Article 237.

The successive instalments, including the above sum, paid over by Germany in satisfaction of the above claims, will be divided by the Allied and Associated Governments in proportions which have been determined upon by them in advance on a basis of general equity and the rights of each.

## Article 238.

In addition to the payments mentioned above Germany shall effect, in accordance with the procedure laid down by the Reparation Commission, restitution in cash of cash taken away, seized or sequestrated, and also restitution of animals, objects of every nature and securities taken away, seized or sequestrated, in the cases in which it proves possible to identify them in territory belonging to Germany and her Allies.

## Annex i.

Compensation may be claimed from Germany under Article 232 above in respect of the total damage under the following categories:

(1) Damage to injured persons and to surviving dependents by personal injury to or death of civilians caused by acts of war, including bombardments or other attacks on land, on sea, or from the air.

(7) Allowances by the governments of the Allied and Associated Powers to families and dependents of mobilised persons or persons serving with the forces.

(10) Damage in the form of levies, fines and other similar exactions imposed by Germany or her allies upon the civilian population.

## Annex ii.

(a) Whatever part of the full amount of the proved claims is not paid in gold, or in ships, securities and commodities or otherwise, Germany shall be required, under such condition as the Commission may determine, to cover by way of guarantee by an equivalent issue of bonds, obligations or otherwise, in order to constitute an acknowledgment of the said part of the debt.

(b) In periodically estimating Gremany's capacity to pay, the Commission shall examine the German system of taxation, first, to the end that the sums for reparation which Germany is required to pay shall become a charge upon all her revenues prior to that for the service or discharge of any domestic loans, and, secondly, so as to satisfy itself that, in general, the German scheme of taxation is fully as heavy proportionally as that of any of the Powers represented on the Commission.

(c) In order to facilitate and continue the immediate restoration of the economic life of the Allied and Associated countries, the Commission shall take from Germany by way of security for and acknowledgment of her debts a first instalment of gold bearer bonds.

(1) To be issued forthwith, mk. 20,000,000,000 gold bearer bonds, payable not later than May 1, 1921, without interest.

(2) To be issued forthwith, further mk. 40,000,000,000 gold bearer bonds, bearing interest at 2½ per cent per annum between 1921 and 1926, and thereafter at 5 per cent per annum with an additional 1 per cent for amortisation beginning in 1926 on the whole amount of the issue.

(3) To be delivered forthwith a covering undertaking in writing to issue when, but not until, the Commission is satisfied that Germany can meet such interest and sinking-fund obligations, a further instalment of mk. 40,000,000,000 gold 5 per cent bearer bonds, the time and mode of payment of principal and interest to be determined by the Commission. *Further issues by way of acknowledgment and security may be required as the Commission subsequently determines from time to time.*

## DEBT FUNDING BILL

(PUBLIC—NO. 139—67TH CONGRESS.)

(H. R. 8762.)

An Act To create a commission authorized under certain conditions to refund or convert obligations of foreign Governments held by the United States of America, and for other purposes.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That a World War Foreign Debt Commission is hereby created consisting of five members, one of whom shall be the Secretary of the Treasury, who shall serve as chairman, and four of whom shall be appointed by the President, by and with the advice and consent of the Senate.

SEC. 2. That, subject to the approval of the President, the commission created by section 1 is hereby authorized to refund or convert, and to extend the time of payments of the principal or the interest, or both, of any obligation of any foreign Government heretofore received by the United States of America (including obligations held by the United States Grain Corporation, the War Department, the Navy Department, or the American Relief Administration), arising out of the World War, into bonds or other obligations of such foreign Government in substitution for the bonds or other obligations of such Government now or hereafter held by the United States of America, in such form and of such terms, conditions, date or dates of maturity, and rate or rates of interest, and with such security, if any, as shall be deemed for the best interests of the United States of America. *Provided,* That nothing contained in this Act shall be construed to authorize or empower the commission to extend the time of maturity of any such bonds or other obligations due the United States of America by any foreign Government beyond June 15, 1947, or to fix the rate of interest at less than 4½ per centum per annum: *Provided further,* That when the bond or other obligation of any such Government has been refunded or converted as herein provided, the authority of the commission over such refunded or converted bond or other obligation shall cease.

SEC. 3. That this Act shall not be construed to authorize the exchange of bonds or other obligations of any foreign Government for those of any other foreign Government, or cancellation of any part of such indebtedness except through payment thereof.

SEC. 4. That the authority granted by this Act shall cease and determine at the end of three years from the date of the passage of this Act.

SEC. 5. That the annual report of this commission shall be included in the Annual Report of the Secretary of the Treasury on the state of the finances, but said commission shall immediately transmit to the Congress copies of any refunding agreements entered into, with the approval of the President, by each foreign Government upon the completion of the authority granted under this Act.

Approved, February 9, 1922.

## TABLE I.

### GREAT BRITAIN

### REVENUE, BORROWINGS, AND EXPENDITURE

For Fiscal Year Ending March 31st (000,000's omitted)

Source: Kir Kaldy, British Finance

| | 1914 | 1915 | 1916 | 1917 | 1918 | 1919 | 1920 | 1921 |
|---|---|---|---|---|---|---|---|---|
| | L. | L. | L. | L. | L. | L. | L. | L. |
| Revenue ............. | 198 | 226 | 336 | 573 | 707 | 889 | 1,339 | 1,425 |
| Net Borrowings...... | 3 | 406 | 1,164 | 1,625 | 1,983 | 1,682 | 322 | [1] 236 |
| | 201 | 633 | 1,501 | 2,198 | 2,690 | 2,571 | 1,662 | 1,189 |
| Change in Exchequer Balances[2] ............ | +4 | +73 | —57 | | —5 | —8 | —3 | —6 |
| Total Expenditure | 197 | 560 | 1,559 | 2,198 | 2,696 | 2,579 | 1,665 | 1,195 |
| **Percentage of Total Expenditure** | | | | | | | | |
| Revenue ............. | 100. | 40. | 21. | 26. | 26. | 34. | 80. | 119. |
| Net Borrowings...... | 1. | 72. | 74. | 73. | 73. | 65. | 19. | [1] 19. |
| | 102. | 113. | 96. | 100. | 99. | 99. | 99. | 99. |
| Change in Exchequer Balances[2] ........... | +2. | +13. | —3. | +0. | —0. | —0. | —0. | —0. |
| Total Expenditure | 100. | 100. | 100. | 100. | 100. | 100. | 100. | 100. |

[1] Net Repayments.

[2] Subtract Increase +, Add Decrease —.

## TABLE II.

### FRANCE. BUDGET.

(000,000's omitted)

| Revenues: | 1920 Estimate[1] | 1920 Actual[2] | 1921[3] Estimate | 1921[3] Actual | 1922[4] Estimate | 1922[4] Actual |
|---|---|---|---|---|---|---|
| Direct Taxes.............. | 1,923 | 757 | 2,776 | 945 | 3,300 | |
| Indirect Taxes............ | 8,484 | [5]12,060 | 14,346 | 13,234 | 16,120 | |
| Monopolies ............... | 1,998 | | | | | |
| War Profits............... | 4,000 | 2,393 | 10,325 | 7,578 | 3,050 | |
| Tax Sales of War Stores.. | 2,915 | 1,650 | 1,500 | 1,501 | 500 | |
| Sundries ................. | 2,450 | 727 | | | [6]1,320 | |
| Total Receipts........ | 21,770 | 18,945 | 28,947 | 22,609 | 24,290 | |
| Deficit ............... | | 33,493 | | 35,391 | | |
| | | 52,438 | | 58,000 | | |

Sources:

[1] Journal Officiel, August 1, 1920.

[2] Friedman, op. cit., p. 122, Vol.

[3] Economist (London), Vol. xciv, p. 127.
Henri Cheron, Statement, March 19, 1921.
Bulletin du Statistique et de Législation comparée, Vol. lxxxix, p. 831 et seq.

[4] Federal Reserve Bulletin, February, 1922.
Journal des Debats, July 9, 1921.

[5] Indirect Tax and Monopolies not separated.

[6] To be raised by sale of short-term bills.

### FRANCE. BUDGET.

Expenditures: (000,000's omitted)

| Ordinary Budget: | 1920 Estimate[1] | 1920 Actual[2] | 1921 Estimate[3] | 1921 Actual[3] | 1922 Estimate[4] | 1922 Actual |
|---|---|---|---|---|---|---|
| Service of Public Debt.... | 11,633 | | 10,244 | | 12,866 | |
| Military Expenses........ | 3,516 | | 4,613 | | 4,821 | |
| Expenses of Ministries.... | 4,113 | | [5]7,470 | | 5,224 | |
| Miscellaneous ............ | 2,499 | | | | 2,475 | |
| Extraordinary Budget..... | 5,420 | | 5,499 | | | |
| Expenses recoverable from Germany ............... | 20,751 | | 16,575 | | 19,159 | |
| Total Estimated...... | 47,932 | | 44,401 | | 53,861 | |
| Supplementary ....... | | 4,506 | | 13,600 | | |
| Total Actual.......... | | 52,438 | | 58,001 | | |

[1] Journal Officiel, August 1, 1920.

[2] Bulletin de Statistique et de Législation comparée, Vol. lxxxix, p. 831 et seq.
Economiste Français, November 13, 20, 27, 1920.

[3] Henri Cheron, Statement in Senate, March 19, 1921.
Journal des Debats, December 12, 13, 1920.

[4] Discussion of 1922 Budget, Senate, December 31, 1921, January 1, 1922.
Journal of Commerce, February 17, 1922.
Federal Reserve Bulletin, February, 1922.

[5] Expense of Ministries and Miscellaneous totaled together.

## TABLE III.

ITALY. REVENUES AND EXPENDITURES. In Lira.

(000,000's omitted)

| | 1920 | | 1921 | | 1922 | |
|---|---|---|---|---|---|---|
| | Estimated[1] | Actual[2] | Estimated[2] | Actual[3] | Estimated[2] | Actual[3] |
| Revenue ........ | 11,530 | 14,233 | 11,001 | 18,071 | 14,787 | 18,336 |
| Borrowings ..... | 660 | 8,833 | 13,430 | 10,712 | 9,710 | 5,012 |
| Total Expenditure .... | 12,190 | [4] 23,066 | 24,438 | 28,783 | 24,497 | [5] 23,348 |

Sources:

[1] Frankfurter Zeitung, October 20, 1920.

[2] F. Meda, Minister of Finance Statement, Chamber of Deputies, December 19, 1920.

[3] Federal Reserve Bulletin, February, 1922.

[4] Revised Estimate.

[5] Does not include 6,000,000,000 Lire for bread subsidy nor 1,000,000,000 for Railway Deficit.

## TABLE IV.

### GERMANY—EXPENDITURES AND RECEIPTS

(In marks—000,000's omitted)

| Expenditures: | 1920 [1] Estimate | Actual | [2] 1921 [3] Estimate | Actual | [3] 1922 [4] Estimate | Actual | 1923 Estimate | Actual |
|---|---|---|---|---|---|---|---|---|
| Ordinary | ...... | 15,309 | 35,193 | 35,980 | 46,945 | 81,000 | 77,000 | |
| Extra | ...... | 42,749 | 4,787 | 24,000 | 17,617 | 40,000 | 11,000 | |
| Peace Treaty | ...... | ...... | ...... | [5]42,000 | 26,050 | 112,900 | 228,000 | |
| Total | [6]17,500 | 58,058 | 39,980 | 101,980 | 90,612 | 233,900 | 316,000 | |
| Receipts: | | | | | | | | |
| Permanent Taxes[6] | ...... | ...... | [2]23,320 | [3] | 25,703 | [6] | 68,000 | |
| Non-recurrent[6] | ...... | ...... | 4,500 | ...... | 2,000 | ...... | 3,000 | |
| Customs Consumption | ...... | ...... | 9,147 | ...... | 10,589 | ...... | 23,000 | |
| Export Duties | ...... | ...... | 700 | ...... | 700 | ...... | ...... | |
| Others | ...... | ...... | 2,233 | ...... | 7,896 | ...... | 6,000 | |
| Total Receipts | 7,000 | [7]15,309 | 39,897 | 27,700 | ...... | 72,400 | 100,300 | |
| Deficit | 10,500 | 42,749 | 83 | 74,280 | 41,379 | 161,500 | 216,000 | |
| Total | 17,500 | 58,059 | 39,980 | 101,980 | 90,612 | 233,900 | 316,300 | |

Sources:

[1] Bulletin de Statistiques et de Legislation comparée, Vol. lxxxviii, p. 705.

[2] Law of March 26, 1921.

[3] Frankfurter Zeitung, June 28, 1921.

[4] Dr. Popotz' statement to Reichstag tax committee, December 6, 1921. Federal Reserve Bulletin, February, 1922.

[5] Does not include 20,000,000,000 marks for the Army of Occupation.

[6] Taxes in many instances were left indeterminate and correct figures are not available.

[7] Ordinary receipts include:
- 4,041,000,000 old taxes.
- 9,000,000,000 new taxes to be levied under laws of 1919: Sept. 8, 10, 12, 16; Dec. 24 and 31. 1920: March 27, 29, 30.
- 2,208,000,000 miscellaneous.

## TABLE V.

### BANK OF ENGLAND

### BANKING DEPARTMENT—LIABILITIES.

Source: London Economist.

| 1913 | Proprietor's Capital £ | Rest £ | Public[1] Deposits £ | Other Deposits £ | 7-Day and Other Bills £ | Total £ |
|---|---|---|---|---|---|---|
| Aug. 6..... | 14,553 | 3,512 | 9,350 | 39,822 | 13 | 67,252 |
| 1914: | | | | | | |
| July 22.... | 14,553 | 3,446 | 13,735 | 42,185 | 14 | 73,934 |
| July 29.... | 14,553 | 3,491 | 12,713 | 54,418 | 10 | 85,187 |
| 1915: | | | | | | |
| Aug. 4..... | 14,553 | 3,450 | 147,058 | 84,221 | 41 | 249,324 |
| 1916: | | | | | | |
| Aug. 2..... | 14,553 | 3,410 | 51,009 | 85,517 | 31 | 154,522 |
| 1917: | | | | | | |
| Aug. 1..... | 14,553 | 3,399 | 44,811 | 128,744 | 16 | 191,524 |
| 1918: | | | | | | |
| July 31.... | 14,553 | 3,434 | 37,789 | 138,440 | 10 | 194,227 |
| 1919: | | | | | | |
| July 30.... | 14,553 | 3,364 | 17,881 | 116,554 | 13 | 152,366 |
| 1920: | | | | | | |
| Aug. 4..... | 14,553 | 3,405 | 17,462 | 130,685 | 16 | 166,123 |
| 1921: | | | | | | |
| May 4..... | 14,553 | 3,133 | 15,437 | 125,369 | 10 | 158,504 |
| 1922: | | | | | | |
| Feb. 8..... | 14,553 | 3,475 | 14,721 | 154,413 | 16 | 187,180 |

[1] Including Exchequer, Savings Banks, Commissioners of National Debt, and Dividend Accounts.

### BANKING DEPARTMENT—ASSETS

Source: London Economist.

| 1913: | Government Securities £ | Other Securities £ | Notes £ | Gold and Silver £ | Total £ |
|---|---|---|---|---|---|
| Aug. 6 ........... | 12,756 | 28,988 | 26,013 | 1,493 | 67,252 |
| 1914: | | | | | |
| July 22 .......... | 11,005 | 33,632 | 27,697 | 1,599 | 73,934 |
| July 29 .......... | 11,005 | 47,307 | 25,415 | 1,460 | 85,187 |
| 1915: | | | | | |
| Aug. 4 ........... | 46,874 | 155,264 | 46,171 | 1,013 | 249,324 |
| 1916: | | | | | |
| Aug. 2 ........... | 42,188 | 75,657 | 34,702 | 1,974 | 154,522 |
| 1917: | | | | | |
| Aug. 1 ........... | 50,439 | 110,654 | 27,819 | 2,610 | 191,524 |
| 1918: | | | | | |
| July 31 .......... | 58,601 | 106,787 | 28,142 | 696 | 194,227 |
| 1919: | | | | | |
| July 30 .......... | 43,143 | 81,745 | 25,294 | 2,183 | 152,366 |
| 1920: | | | | | |
| Aug. 4 ........... | 76,265 | 74,788 | 13,490 | 1,578 | 166,123 |
| 1921: | | | | | |
| May 4 ........... | 61,667 | 79,558 | 15,461 | 1,817 | 158,504 |
| 1922: | | | | | |
| Feb. 8 ........... | 82,223 | 80,425 | 22,708 | 1,822 | 187,180 |

## TABLE VI.

### STATEMENTS OF THE BANK OF FRANCE.[1]

(In million francs)

ASSETS.

| | Total Metallic Reserve | Foreign Credits | War Advances to Government | Loans and Discounts | Advances on Bullion, Specie, Securities, etc. |
|---|---|---|---|---|---|
| 1913: | | | | | |
| Dec. 26 | 4,157 | ...... | ...... | 1,527 | 772 |
| 1914: | | | | | |
| July 30 | 4,766 | ...... | ...... | 2,444 | 759 |
| Dec. 10[2] | 4,493 | ...... | 3,600 | 213 | [3]780 |
| 1915: | | | | | |
| Dec. 30 | 5,367 | 1,057 | 5,000 | 429 | 1,152 |
| 1916: | | | | | |
| Dec. 28 | 5,371 | 826 | 7,400 | 619 | 1,318 |
| 1917: | | | | | |
| Dec. 27 | 5,599 | 778 | 12,500 | 918 | 1,225 |
| 1918: | | | | | |
| Dec. 26 | 5,795 | 2,337 | 17,150 | 1,052 | 1,216 |
| 1919: | | | | | |
| Dec. 26 | 5,846 | 1,297 | 25,500 | 1,287 | 1,464 |
| 1920: | | | | | |
| June 24 | 5,828 | 860 | 26,000 | 1,787 | 1,861 |
| Dec. 30 | 5,767 | 678 | 26,600 | 3,311 | 2,202 |
| 1921: | | | | | |
| June 23 | 5,794 | ...... | ...... | 2,896 | 2,292 |
| Dec. 31 | 5,303 | 623 | 23,336 | 2,465 | 2,250 |

[1] Economiste Français and weekly returns of Bank of France.
[2] No data available as at end of 1914.
[3] Advances on securities only.

### STATEMENTS OF THE BANK OF FRANCE.[1]

(In million francs)

LIABILITIES.

| | Other Deposits | Bank Notes in Circulation |
|---|---|---|
| 1913: | | |
| Dec. 26 | 575 | 5,714 |
| 1914: | | |
| July 30 | 951 | 6,683 |
| Dec. 10[2] | 2,671 | 9,986 |
| 1915: | | |
| Dec. 30 | 2,114 | 13,310 |
| 1916: | | |
| Dec. 28 | 2,260 | 16,679 |
| 1917: | | |
| Dec. 27 | 2,913 | 22,337 |
| 1918: | | |
| Dec. 26 | 2,366 | 30,250 |
| 1919: | | |
| Dec. 26 | 3,127 | 37,274 |
| 1920: | | |
| June 24 | 3,578 | 37,544 |
| Dec. 30 | 3,518 | 37,902 |
| 1921: | | |
| June 23 | 2,770 | ..... |
| Dec. 31 | 1,589 | 36,480 |

[1] Economiste Français and weekly returns of Bank of France.
[2] No data available as at end of 1914.

## TABLE VII.

ITALIAN BANKS OF ISSUE.[1]

(In lira, 000,000's omitted)

| | Circulation Note | Obligations Deposit | Reserve Gold | Ratio [2]Reserve |
|---|---|---|---|---|
| 1913: | | | | |
| December | 2,284 | 318 | 1,661 | 63.9% |
| 1920: | | | | |
| January | 15,634 | 2,376 | 2,021 | 11.2% |
| June | 17,817 | 2,379 | 2,110 | 10.5% |
| December | 19,731 | 2,559 | 2,077 | 9.3% |
| 1921: | | | | |
| March | 18,765 | 2,461 | 2,043 | 9.6% |
| June | 18,159 | 2,366 | 1,989 | 9.7% |

[1] Bankers Statistics Corporation, New York, 1920, "The Banking Situation of Foreign Countries."

[2] Gold reserve to note circulation and deposit obligations.

**TABLE VIII.**

STATEMENTS OF THE REICHSBANK.

(In million marks)

Source: Die Bank.

| | Gold | Paper Money[1] | Commercial Bills, Checks, Treas. Bills | Bank Notes in Circulation | Deposits |
|---|---|---|---|---|---|
| 1913: | | | | | |
| Jan. 7..... | 1,204 | 81 | 1,168 | 2,303 | 804 |
| June 30.... | 1,306 | 60 | 1,213 | 2,407 | 858 |
| July 23.... | 1,357 | 105 | 751 | 1,891 | 944 |
| Dec. 31.... | 2,093 | 880 | 3,937 | 5,046 | 1,757 |
| 1915: | | | | | |
| June 30.... | 2,388 | 514 | 4,918 | 5,840 | 1,799 |
| Dec. 31.... | 2,445 | 1,291 | 5,803 | 6,918 | 2,359 |
| 1916: | | | | | |
| June 30.... | 2,466 | 634 | 6,610 | 7,241 | 2,371 |
| Dec. 31.... | 2,520 | 423 | 9,610 | 8,055 | 4,564 |
| 1917: | | | | | |
| June 30.... | 2,457 | 452 | 10,962 | 8,699 | 5,693 |
| Dec. 31.... | 2,407 | 1,315 | 14,598 | 11,468 | 8,050 |
| 1918: | | | | | |
| June 30.... | 2,346 | 1,787 | 16,671 | 12,510 | 9,181 |
| Nov. 7.... | 2,550 | 3,190 | 19,444 | 16,959 | 9,326 |
| Dec. 31.... | 2,262 | 5,270 | 27,416 | 22,188 | 13,280 |
| 1919: | | | | | |
| June 30.... | 1,116 | 9,062 | 33,293 | 29,968 | 13,730 |
| Dec. 31.... | 1,089 | 11,927 | 41,745 | 35,698 | 17,072 |
| 1920: | | | | | |
| March 31.. | 1,091 | 13,974 | 44,576 | 45,170 | 18,498 |
| June 30.... | 1,092 | 17,254 | 50,954 | 53,975 | 23,414 |
| Dec. 31.... | 1,092 | 23,417 | 60,634 | 68,806 | 22,327 |
| 1921: | | | | | |
| March 31.. | 1,091 | 23,836 | 66,802 | 64,382 | 33,077 |
| June 30.... | 1,091 | 8,311 | [2]69,248 | 75,321 | 20,392 |
| Dec. 31.... | 995 | 6,963 | 133,392 | 113,639 | 32,905 |

[1] Reichskassenscheine—total issue mk. 360 millions, of which 30 millions on the average are kept by the Reichsbank.

Darlehnskassenscheine and banknotes of four note banks (Sächsische Bank, Badensche Bank, Württembergische Bank, Bayerische Notenbank—total issue about 250 millions, of which in recent years only 3 millions on an average were kept by the Reichsbank.

[2] For June 15, 1921.

## TABLE IX.

### BRITISH EMPIRE—FOREIGN TRADE.

### EXPORTS.

| | 1919 | 1920 | 1921 |
|---|---|---|---|
| | £ | £ | £ |
| January | 51,903 | 131,344 | 102,711 |
| February | 52,034 | 108,567 | 76,226 |
| March | 62,057 | 130,730 | 75,696 |
| April | 71,828 | 126,659 | 68,391 |
| May | 75,839 | 139,579 | 50,320 |
| June | 76,526 | 136,476 | 45,235 |
| July | 77,072 | 155,300 | 52,533 |
| August | 90,084 | 128,271 | 61,344 |
| September | 82,249 | 130,806 | 63,842 |
| October | 98,702 | 128,429 | 72,650 |
| November | 107,376 | 132,479 | 72,718 |
| December | 117,018 | 109,329 | 68,578 |
| Corrected Total for Year | 962,694 | 1,557,222 | [1]810,248 |

### IMPORTS.

| | 1919 | 1920 | 1921 |
|---|---|---|---|
| | £ | £ | £ |
| January | 134,546 | 183,342 | 117,050 |
| February | 105,689 | 170,434 | 96,173 |
| March | 105,752 | 176,567 | 93,741 |
| April | 112,065 | 167,129 | 89,995 |
| May | 135,612 | 166,414 | 86,308 |
| June | 122,945 | 170,265 | 88,182 |
| July | 153,140 | 163,126 | 80,757 |
| August | 148,832 | 153,343 | 88,581 |
| September | 148,625 | 152,757 | 87,118 |
| October | 153,486 | 149,631 | 84,741 |
| November | 143,564 | 144,238 | 89,258 |
| December | 169,735 | 142,687 | 85,312 |
| Corrected Total for Year | 1,631,901 | 1,932,648 | 1,086,687 |

Source: Accounts of Navigation and Trade (monthly), 1919-1921.

## TABLE X.

### FRANCE—FOREIGN COMMERCE.

### FIRST TEN MONTHS OF 1919, 1920, 1921

(In francs, 000,000's omitted) (In tons, 000's omitted)

| Groups of Merchandise: | 1921 [1]Value | 1921 Weight | 1920 Value | 1920 Weight | 1919 Value | 1919 Weight |
|---|---|---|---|---|---|---|
| IMPORTS | | | | | | |
| Foodstuffs ...... | 4,887 | 3,239 | 10,221 | 5,362 | 8,920 | 5,820 |
| Raw Materials... | 9,095 | 23,191 | 20,735 | 33,203 | 12,290 | 24,700 |
| Manufactured Goods ........ | 4,077 | 1,186 | 10,823 | 2,091 | 8,620 | 1,520 |
| Total ......... | 18,060 | 27,616 | 41,779 | 40,657 | 29,830 | 32,040 |
| EXPORTS: | | | | | | |
| Foodstuffs ...... | 1,516 | 969 | 2,083 | 986 | 990 | 440 |
| Raw Materials... | 4,530 | 9,378 | 5,073 | 7,645 | 2,040 | 3,460 |
| Manufactured Goods ........ | 10,524 | 1,613 | 14,597 | 1,580 | 6,870 | 730 |
| Total ......... | 16,570 | 11,960 | 11,753 | 10,211 | 9,900 | 4,630 |

Source: Bulletin de Statistique (France), November, 1921.

[1] On the basis of prices of 1920.

## TABLE XI.

### ITALY—FOREIGN COMMERCE

### DURING THE FIRST SIX MONTHS OF 1921.

| | Importations (In Lira) | | Exportations | |
|---|---|---|---|---|
| | 1921 | 1920 | 1921 | 1920 |
| Beverages and Oils........ | 654,429 | 816,231 | 232,907 | 261,359 |
| Colonial Commodities and Tobacco ........... | 608,288 | 671,339 | 18,244 | 28,704 |
| Dyes and Paints.......... | 278,985 | 533,921 | 154,330 | 321,806 |
| Textile Fabrics, Jute, etc.. | 65,915 | 113,717 | 193,135 | 708,147 |
| Cotton .................. | 1,605,794 | 1,786,124 | 832,220 | 900,879 |
| Wool and Hair............ | 524,665 | 1,103,652 | 331,505 | 93,000 |
| Silk ...................... | 180,340 | 471,556 | 1,486,678 | 522,155 |
| Timber .................. | 290,550 | 257,393 | 140,290 | 158,984 |
| Paper .................... | 144,225 | 175,004 | 47,966 | 59,268 |
| Skins .................... | 368,433 | 593,590 | 214,845 | 129,870 |
| Ores and Metals.......... | 1,333,926 | 1,450,927 | 356,389 | 257,205 |
| Machinery ............... | 65,420 | 150,411 | 195,074 | 145,105 |
| Pottery, Glass and Crystals | 1,705,691 | 1,760,390 | 208,539 | 233,449 |
| India Rubber ............. | 60,078 | 113,073 | 98,900 | 143,710 |
| Cereals, Flour, &c......... | 4,764,930 | 3,035,588 | 511,435 | 679,123 |
| Animals and Animal Products........ | 535,801 | 665,454 | 75,044 | 74,700 |
| Sundries ................ | 92,655 | 109,749 | 168,052 | 243,394 |
| Precious Metals........... | 3,087 | 10,641 | 575 | 52 |
| Total .................. | 13,457,607 | 14,007,058 | 5,282,250 | 5,985,210 |

Source: Bulletin de Statistique (France), November, 1921.

## TABLE XII.

### GERMANY—FOREIGN TRADE IN 1920.

### EXPORTATIONS (In marks—000's omitted)

| Groups of Commodities: | 1920 | 1913 |
|---|---|---|
| 1. Foodstuffs, Fodder, Timber | 3,835,812 | 1,728,157 |
| 2. Mineral, Raw materials, Oils | 5,040,787 | 896,805 |
| 3. Fats, Oils, Wax Products | 117,983 | 52,283 |
| 4. Chemicals, Dyes, Artificial Fertilizers | 8,958,122 | 956,414 |
| 5. Textiles | 8,436,449 | 1,560,550 |
| 6. Leather, Furs | 2,483,709 | 553,219 |
| 7. Rubber | 295,827 | 128,284 |
| 8. Wicker goods, Brushes | 232,606 | 20,739 |
| 9. Carved articles | 1,584,180 | 164,471 |
| 10. Paper, Papier mache | 3,086,680 | 262,683 |
| 11. Books, Pictures | 380,372 | 104,807 |
| 12. Earthenware | 413,171 | 34,151 |
| 13. Crockery | 1,114,880 | 112,787 |
| 14. Glassware | 1,767,974 | 146,024 |
| 15. Metals | 16,798,123 | 1,905,596 |
| 16. Machinery, Vehicles | 11,270,005 | 1,143,384 |
| 17. Arms, Clocks, Instruments | 2,591,510 | 233,129 |
| Total | 69,524,476 | 10,181,978 |

Source: Bulletin de Statistique et de Législation comparée, November, 1921.

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